

**Institutional Complementarities and Change:
the Relationship between Production and Welfare Regimes
in Korea**

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I. Introduction

The NIEs in East Asia are today undergoing institutional instabilities and changes under the pressure of democratization and globalization. They have faced different environment both domestically and internationally in comparison with the past high-growth period in which the strong developmental state played a dominant role in coordinating various institutions of production and welfare regimes.

Korea is no except to these changes. Perhaps the Korean political economy is today significantly changing more than any other neighbor East Asian countries. Since the post-financial crisis in Korea, globalization pressures and the power shift to the popular sector by the Kim Dae Jung and Roh Moo-hyun governments in the democratization process, interacting with each other, are now critically affecting the power relations among various social groups and classes and reshaping the economy and social welfare now and into the future.

Although the previous two relatively progressive governments had attempted to search for new equilibriums for solving the current problems, the recent changes especially since the financial crisis in 1999 are apparently changing toward a liberal type of welfare capitalism as a result of the comprehensive neo-liberal reforms. Is that so? It seems that the Korean political economy is now very unstable by revealing some critical tensions among the institutions in the production and welfare regimes as well as the relevant politics, and thus falling in the process of a critical historical conjuncture in searching for a new paradigm of the welfare capitalism adapting to these changes.

How can we interpret Korea's current changes and responding strategies? How much have the past institutional legacies of the developmental state changed and created new paths for institutional change to the future? In other words, to what extent have the current changes revealed the path-dependent nature from the past institutional legacies and to what direction is the Korean welfare capitalism really moving?

The varieties of capitalism(VOC) approach has been getting attention as a useful analytical tool for explaining the existence of the different types of the political economies and their continuities and changes through time. Institutional complementarities and modes of coordination (or coordination mechanism) seem to be key concepts in the VOC perspective for explaining institutional continuities and changes in response to the endogenous as well as exogenous challenges.

Based on these analytical tools, this paper tentatively attempts to identify what kind of institutional complementarities and modes of coordination have been formed between the core institutional domains in the production and welfare regimes in Korea and explaining why and how they are changing. By doing so, this paper aims at evaluating the usefulness as an analytical framework based on the VOC perspective and obtaining some theoretical and empirical implications in explaining the recent changes in the political economies in the East Asian context.

II. Analytical framework: Institutional Complementarities and Modes of Coordination

1. Putting the VOC perspective in the East Asian context

The perspectives of Varieties of Capitalism (VOC), which have recently attracted much attention from many scholars in the field of comparative political economy, seems to provide a useful analytical framework for explaining the distinctive institutional features of national economy or welfare capitalism in each country and their continuities and changes under the pressures of globalization. By placing a methodological view at the institutional level, the VOC approaches adopt the Polanyi's view of the great transformation of modern capitalism, on the one hand, and an analytical idea of the French regulation theory that focuses on a social system of production as the center of the analysis of capitalism, on the other. Especially this approach examines 'the production regime' by emphasizing a business-centered relationship with other related production subsystems, i.e. industrial policies, macro-economic management, financial system, industrial relations, corporate governance, skill systems, and so on (Hollingworth and Boyer 1997; Crouch and Streek, 1997; Kitschelt, Lange, Marks, Stephen 1999; Hall and Soskice 2001).

This view argues that each national production system has developed through its own historical process, in which major historical actors (business/capital, labor, and state) interact under given international and domestic institutional conditions and the 'institutional complementarities' between the subsystems of the national production system have evolved with certain economic performances.¹

¹ The conceptualization and the theoretical functions of the institutional complementarities in explaining institutional continuity and change are now becoming the object of the intensive debates among the scholars in

The recent scholarship from the VoC began to broaden its analytical view and research questions to the 'institutional complementarities' between the major subsystems/institutions of the production regime and the welfare regime--that is, the economic-welfare nexus (i.e., corporate governance and pension system, skill system and unemployment insurance)--and explore the 'elective affinities' between different types of production and welfare regimes (Huber and Stephens 2000; Hall and Soskice, 2001; Manow and Ebbinghaus, 2001, Mares 2001; Swenson 2002; Iversen, 2005). By doing so, it tries to find the relationships among institutional competitiveness, distributional consequences, and political institutions and ruling coalition.

This view criticizes the limitations of the previous Esping-Andersen's theory of welfare capitalism in the sense that it focuses too much on the Keynesian aspects of capitalism, that is, the labor side of power relation as a coalitional basis and the distributional consequences of welfare. In fact, they emphasize that the account for the relationship between production and social protection is very important to understand the modern welfare capitalism by focusing on business-centered political coalitions and the production side of welfare. From this view, the production-side view of welfare can explain why countries with high tax and social spending do not necessarily race to the bottom in spite of the decrease in their labor strength and why they are able to maintain competitive economic growth under the pressures of globalization (Iversen, 2005).

Can this approach be useful in understanding the development of welfare capitalism and the recent changes due to the various domestic and global challenges? Recently some academics have begun to emphasize the importance of the welfare-economy nexus in explaining the East Asian welfare system over the cultural explanations, but they still lack a concrete elaboration of the causal mechanisms for how specific welfare programs are related to the aspects of the production system (Holliday 2000; Lue 2002; Ku 1997; Gough 2000; Tang 2000).

Some recent comparative studies crossed the line from the Western-centered context by attempting to explain similarities and differences between Germany and Japan as a non-liberal capitalist economy are very illuminating for this line of research question (Streeck and Yamanuma, 2001 and 2003). According to these literatures, Korea as well as other East Asian neighbor countries been non-liberal, and seem to be different kind of coordinated market

the VOCs. The example literatures are Amable, Ernst, Palombarini (2005), Höpner (2005), Crouch et al. (2005), Deeg (2005), and Streeck and Thelen (2005).

economies in which the developmental state played a crucial role in their rapid industrialization. It has also been assumed that both Japanese and Korean economies could have similar large-business coordinated market economies, although there would be significant differences in the specific coordinating mechanisms and consequences between them (Soskice, 1999). However, specific research has not yet agreed upon what kind of non-liberal or coordinated market economies they were and how they are transitioning today compared with other advanced industrialized countries. More empirical research will be required to identify the specific institutional features and the coordinating mechanisms of these East Asian production and welfare regimes and their institutional complementarities and elective affinities among the various institutional domains of the welfare capitalism in the East Asian context. In the next, I will clarify my conceptualization of institutional complementarities and other related theoretical concepts as key concepts to explain the institutional linkages among different domains of production regime as well as the relationship between production and welfare regime in Korea.

2. Conceptualization of Institutional Complementarities

The recent literature from the VOC began to pay much attention to the concept of institutional complementarities and attempt to make it a useful concept for explaining institutional resilience (path dependence) and, at the same time, institutional change.

First of all, Hall and Soskice claimed that the presence of institutional complementarities is an important criterion for distinguishing between liberal and coordinated market economies (2001: 17). They argue that following the Aoki's basic idea (1994), "if the presence (or efficiency) of one increase the returns from (or efficiency of) the other." (Hall and Soskice, 2001: 17). Sharing with Aoki's reasoning, they give an example of the institutional complementarities long-term employment is more feasible where the financial system provides capital on terms that are sensitive to current profitability. In this line of logic they assume that the existence of certain patterns of institutional complementarities is making a cluster of some different types of capitalism. However, they did not elaborate how those institutions with complementarities are historically and causally forming and contingent upon change. Therefore, some scholars argue that institutional complementarities not only distinguish the typology of nation capitalism, but also should explain why institutions are resistant to change and why introducing new institutions into a

system often leads to unintended consequences or failure to achieve the intended objective (Pierson, 2004; Streeck and Thelen, 2005; Crouch, 2005). Furthermore, whenever scholars use the concept of institutional complementarities in their explanations of the institutional resilience and change, they actually imply different meanings, leading to the confusions.

The concept of institutional complementarities needs to overcome the functionalism and a refined conceptualization and theory for other types of institutional clustering of capitalism and the explanation of the institutional changes. In this context, Streeck emphasizes the possibility of efficiency constraints for institution building and warns to avoid the functionalist trap in explaining institutional complementarities as a grand design (Streeck, 2005). He argues that historical contingency and unintended consequences in the formation of the institutional complementarities are possible ful for explaining institutional change as well as its resilience of change (2005).

At this time, there are two ways to solve this issue: one is to differentiate types of institutional complementarities according to its functioning and roles in the relationships between institutions; second is to elaborate the ontology of institutions to allow the dynamics of institutional complementarities and changes.

Crouch and Deeg already made this problem clear (Crouch, 2005a and b. Deeg, 2005 and 2007). First of all, Crouch, by criticizing the functionalist explanation of institutions and complementarities, suggest three different conceptualizations; i) mutual compensation for each other's deficiencies in constituting the whole, ii) the complementarity in the economist sense, which is the core concept in the CMEs, and iii) the complementarity as mutual effects, referring to "the performance of each is affected by the existence of others" (Crouch, 2005a: 50-54).

Agreeing with Crouch's argument, Deeg suggests two different types of complementarities. According to Deeg, "what is common to all conceptions of complementarity is the core idea that the co-existence of two (or more) institutions together affects the strategic choices of actors and/or will enhance the ability of actors to achieve their objectives. Indeed, it is the very existence of complementarity that makes the whole notion of distinct systems or models of capitalism plausible, since the complementarity presumes that there are a limited number of ways to combine institutional elements successfully." (Deeg, 2007: 612).

First, complementarities can function as a form of 'supplementarity' for each other's institution. In other words, "one institution makes up for the deficiencies of the other, thus

raising the returns to actors from the first institution” (Deeg, 2007: 613). He give us an example such as “when strong familial social support networks offset the vicissitudes of a highly liberalized labor market, thus making the latter more social and politically acceptable while allowing the society to gain the advantages of a liberal labor market.” This meaning could well explain either a LMEs or a society with a strong familialism. I argue that this conceptualization of complementarity could also explain the institutional relationships in Korean case.

Second, Complementarities between institutions function in the form of “synergy.” This embodies the mutually reinforcing effects of compatible incentive structures in different subsystems of an economy. This concept is very similar to the Aoki’s ‘strategic complementarity’, by which the institutions affect each other and create synergy for both (Aoki, 2001). Isomorphic institutions are likely source of this form of complementarity. This is the institutional complementarities that can be found some typical CMEs such as Germany and Japan. Complementarity in the form of synergy may arise different contexts; as Aoki argues this kind of synergic form of complementarity may emerge through deliberate strategic coordination by actors across institutional domains ‘strategic complementarity’, or it may arise through evolutionary (functional) selection or isomorphic change (see also Boyer, 2005; DiMaggio and Powell, 1991), or finally the balanced power relations among major actors can create this kind of complementarity.

How these different types of institutional complementarities are historically emerging in a certain countries at the macro-level? In order to explain this question, we need a historical analysis is necessary rather than a game-theoretic approach, which identify a set of institutional rules and actors’ strategic actions in a given context.

There are other similar concepts that need to be distinguished from that of institutional complementarities. In fact, we can assume that there are many institutional relationships that do not exactly have the institutional complementarities.

First, the concept of ‘institutional coherence’ refers to a situation in which institutions share common or identical principles, which may facilitate interaction among actors operating under them (i.e. institutional isomorphism). Yet this does not necessarily improve performance as a whole. Thus coherence may or may not create complementarities. Nor is coherence a necessary condition for complementarities.

Second, the concept of ‘hierarchy of institutions’ is more related to the political notion of the institutional relationship, which is implying the political equilibrium among the

institutions. Political actors seek political support from a dominant social bloc. They will tend to implement institutional change in a direction that satisfies the existing dominant bloc. Whereas the conceptualization of institutional complementarities implies more or less a symmetrical relationship between two or more institutions, institutional hierarchy stresses asymmetry. A changing environment may modify the strategies of the groups that form the dominant bloc, which in turn may lead to a restructuring or breaking-up of the bloc. This will cause more or less radical institutional change (up to a change of 'model'), depending upon the extent of changes in the pattern of alliance between social bloc and political actors.

Third is the concept of 'Hybridization'. Based on the regulation theory, Boyer suggests the concept of hybridization, which precisely describes the process through which tentatively imported or institutions are transformed via their interaction with domestic institutional forms (Boyer, 2005). This means that there are some degrees of freedom within each general institutional form. Hybridization is a major factor explaining the evolution of institutions and the diversity in institutional architectures. In relation to the hybridization, an important source of dynamics in the institutional formation is the inner development of tensions within a given architecture. The recognition that the fit among institutions is always partial and transitory brings to the fore. Recently, Streeck and Thelen provides various forms of institutional changes and evolution such as layering and conversion (Streeck and Thelen, 2005). In this sense, the hybridization is a useful concept in describing and explaining the transition process or the

3. Make the Concept Dynamic: Importance of Historical and Political Nature of Institutions

The concept of institutional complementarities is implicitly or explicitly, based on a theory of institution. The VOC perspectives, although their theoretical ideas basically borrow from those of the regulation theory, adopts various new institutionalist perspectives: rational choice institutionalism, historical institutionalism, organizational institutionalism, and discursive institutionalism. Therefore, depending upon which institutionalism is one's main methodological base, the explanatory mechanisms of institutional formation and change are different.

Scholars whose methodological perspectives are largely based on historical institutionalism such as Amable and Thelen argue to basically define institutions as power

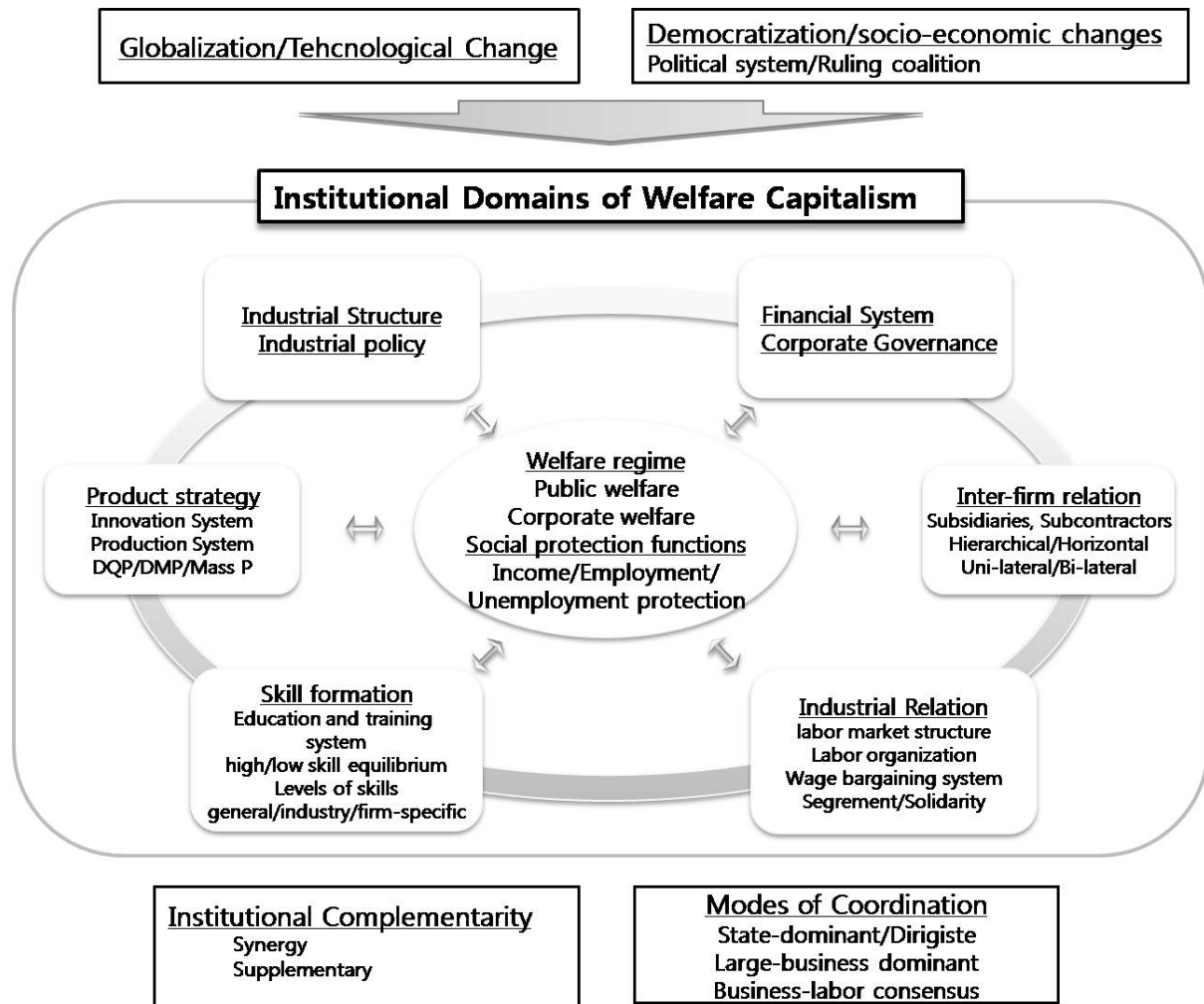
relations or political equilibriums that correspond to a compromise between conflicting social actors. Once the rules of the game are settled as a consequence of political equilibriums, it does not mean abolish social conflicts, but maintain temporal stability. Therefore, rather than directly linking institutions and institutional change to economic performance, one should analyze institutions with respect to the establishment and evolution of social compromises. This is called as ‘continuing negotiation and renegotiation among major historical actors’(Thelen, 2003). Therefore, institutional formation and changes have historical contingencies. Crouch emphasizes that complementarities originally do not have logical relationship, but they are formed as the fortuitous consequences of human creativity. Entrepreneurial actors’ role is very important by intervening at points of change and producing surprising new combinations that unsettle the *ceteris paribus*.

In this context, it would be plausible idea if the further elaborated concept of institutional complementarities and the differentiation of modes of coordination will help us to understanding the distinctive or similar developmental patterns of the national capitalism in East Asian countries.

As Ebbinghaus argues, it is important to understand that institutional elements are only “loosely coupled”, displaying functional interdependency but also varying degrees of inconsistency. Therefore, while different institutional elements of national models are separately governed, the elements are “mutually-supporting and dependent of each other” (1999: 16).

Based on these conceptualizations of institutional complementarities, this paper will analyze the relationships between the following institutional domains with the Korean case, focusing on what kind of coordinating mechanisms are working between the related institutional domains and what kind of institutional complementarities are formed between them.

<Figure 1> An Analytical Framework of Welfare Capitalism
based on the sectoral institutional complementarities



III. Changing Production Regime in Korea: From the State dominant to a Large-Business dominant Coordination

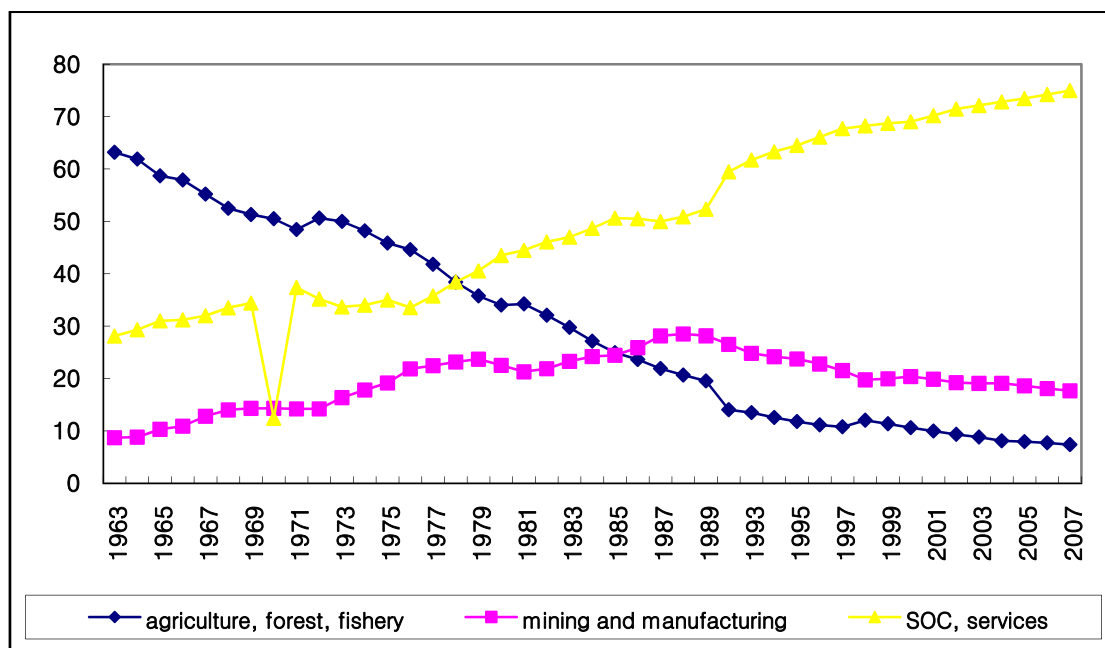
1. Industrial Structure and Industrial Policy: Toward a Large-business dominant industrial Structure

In order to understand how the production regime has developed in Korea, it is important to understand the historical formation of the industrial structure and the role of the state in the process. It is because Korea as a ‘fourth generation’ of the industrialization has a distinctive developmental logic and path, compared with the previous late industrialized countries.²

² It has been known that the first generation of industrialization was England; the second, Germany and the

The historical pattern of the Korea's industrialization was similar with the Japanese one during the first half of the 20th century as well as the postwar period—the tight state control of the financial sector, the large conglomerate-based industrialization, and the role of the super pilot-economic agency in planning and coordinating the industrialization process (Chang, 1992; Johnson, 1982, Woo-Cumings, 1998; Wade, 1990).³ The embedded state autonomy based on the dense network with society allowed the state to effectively mobilize the scarce resources and control social groups for the rapid industrialization (Evans, 1995). In Korea the state and business coalition had been strong with the upper-handed position of the state in the early period of industrialization because the business sector did not have capital and technologies to compete in the world market at the time. The labor organizations and movements had been strictly controlled by the state. In this sense, the state was a main coordinator in the early industrialization.

<Figure 2> Changing Industrial Structure over time (% of employees)



Source: Korea Labor Statistics, Korea Labor Institute. Every year.

<Figure 2> shows how industrial structure in Korea has dynamically changed. Since the industrialization, the agricultural sector rapidly declined. While industrial sector had gradually increased, but since the late 1980s began to gradually decline, instead the service

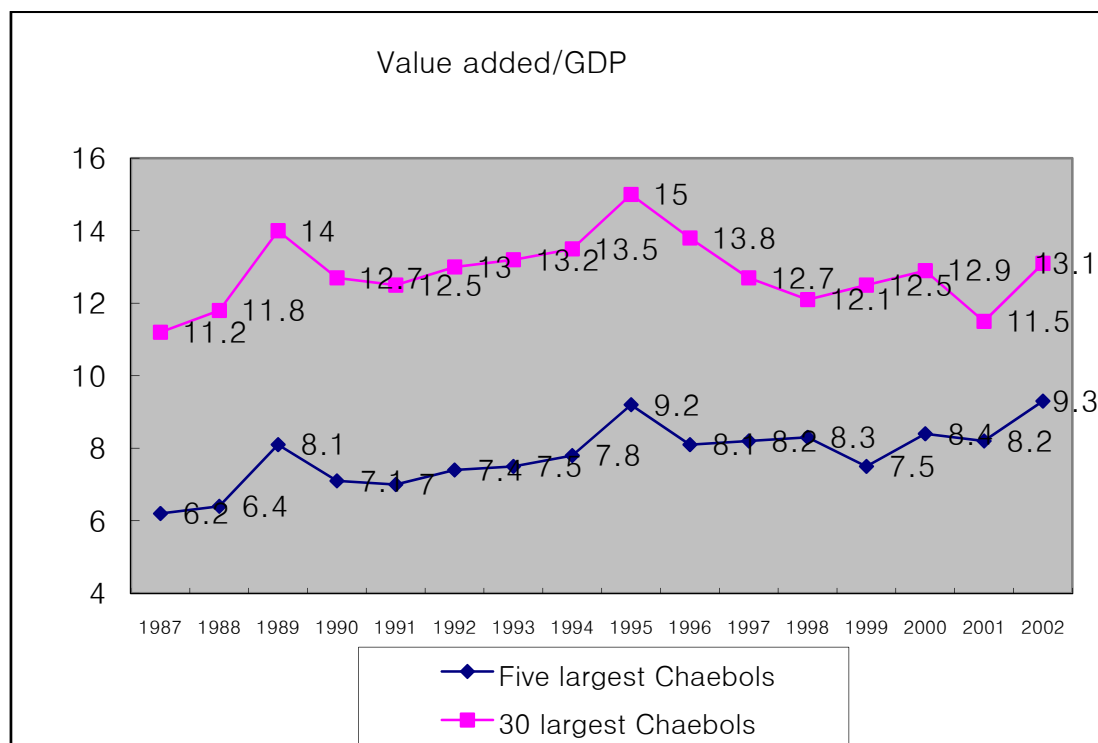
USA; the third, Japan, and the forth, NIEs in Asia and Latin America.

³ For example, the EPB(Economic Planning Board) in Korea, the MITI(Ministry of International Trade and Industry) in Japan, and the CEDP (Council for Economic Planning and Development in Taiwan.

sector is sharply increasing. Today, Korean industrial structure is rapidly moving to the service economy whose labor market structure is dualistic or polarized.

Then, <Figure 3> shows the portion of the value added of the large chaebols in Korean economy. After the HCI, the 30 largest chaebols' have taken more than 10% of the Korean economy. Since the late 1980s The Korean economy has been recently experiencing a rapid transition to service economy or a knowledge-based economy. However the transition is occurring on top of an unbalanced industrial structure and regional development built in the previous state-led industrialization. Aside from the effects of the neo-liberal reforms since the financial crisis, these unbalanced structural gaps became underlying structural causes for aggravating the recent polarization in the labor market, income, and social stratifications (Bang and Chung, 1998; Chung, 1998).

<Figure 3> Value added by large business groups (*Chaebols*) in Korean economy

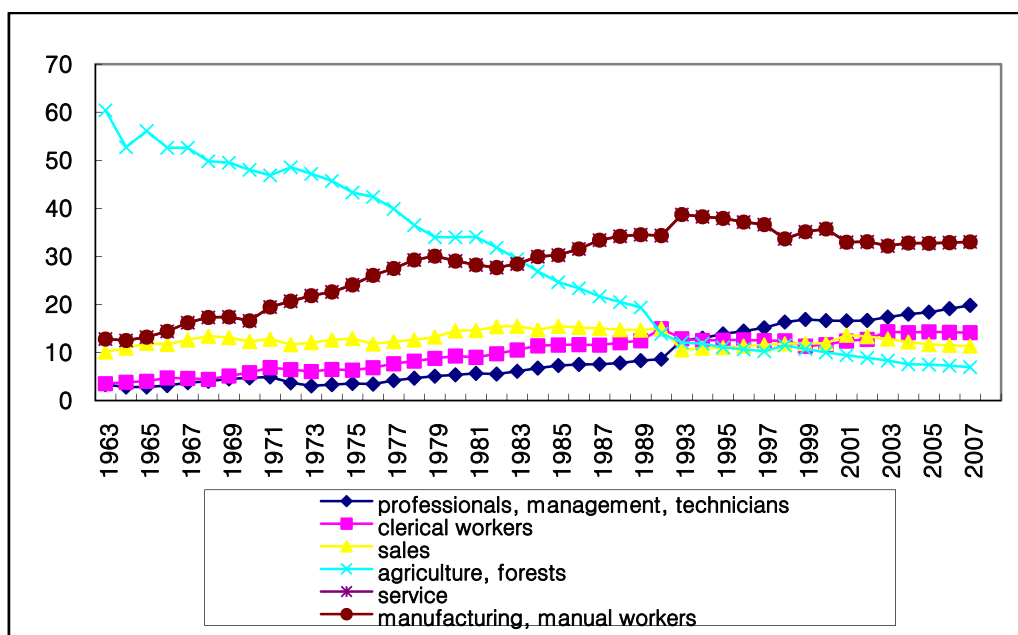


Source: Lee, (2005)

Although the *chaebols* receive much of the attention in the role of the successful economic growth and industrialization in Korea, it is also important to note that the SMEs have still played a large and growing role in the economy, accounting for 99.8% of firms, 87%

of employment, nearly 50% of manufacturing output and 40% of industrial exports in 2003.⁴ However, most of the SMEs in the manufacturing sector depended upon the subcontract relationship with large businesses, resulting in vulnerability to big contractors' unfair or exploitive trading practices. And most SMEs are labor-intensive, low-skilled, and low-wage, while large businesses are high-tech and capital-intensive with less job creation. As many less competitive small-medium firms began to move their factories to less developed countries during the past decade, the Korean manufacturing sector has been declining in terms of its size of the production and employment. In its place the service sector has been rapidly growing, but the jobs being created are mostly low-productivity and low-wage. Thus, this changing industrial structure based on the deepening gap in inter- and intra-industries is becoming now an underlying structural cause for the polarization of labor markets and income distribution.

<Figure 4> Number of employees in major industrial sectors (% of employees)



Data source: Statistical agency's portal website, every year.

In the face of this changing industrial structure it is essential that the Korean economy successfully make a transition toward an innovative and knowledge-based economy.

⁴ The definition of SMEs varies between sectors. In manufacturing, it includes firms with less than 300 employees and no more than 8 billion won in paid-in capital. In the service sector, the employment threshold varies between 30 and 300 employees, and between 2 and 30 billion won in annual sales. The average number of employees per SME is only 3.5 in Korea, compared to between 6 to 7 Japan and Taiwan.

In this context, the government is still implementing various indirect and general industrial policies, which are now different from those in the previous more direct and selective ones. First of all, the Kim Dae Jung government slightly restored the state's coordinating function of the economy, which had been destroyed by the previous Kim Young-sam administration, by creating the Planning and Budget Commission (PBC) and promoting the Ministry of Finance and Economy to vice prime ministries, which places its decision-making power on the upper level of the regular ministries.

Both governments played an active role in promoting high-tech industries, especially IT industry by encouraging infrastructure and increasing the public R&D. The Roh Moo-hyun government selected ten new growth-driven industries for the future growth of the Korean economy. The overall, both governments significantly increased R&D expenditures in collaboration with the private sector. They also constructed not only the national innovation system (NIS) for coordinating the various scientific initiatives and ensuring diffusion of knowledge at the national level, but also the regional innovative system (RIS) for establishing innovative regional clusters for more balanced regional development.⁵ The government is still effectively using institutional networks which link government and business via the various quasi-public organizations and national interest groups. These organizational networks function by sharing information and technologies and coordinating their interests.

Meanwhile, recent research reveals that the Korean economy is on the rise as a result of long and invisible structural adjustment (Kim Joo-Hun, 2007). By removing under-performing enterprises through structural adjustment in the SME sector, new investment can be transferred to technology-intensive industries and businesses. The government has continuously emphasized the role of the R&D investment in upgrading the Korean economy so that the positive effect of long-term structural adjustment also gradually has begun to appear in the SME sector, although still limited (Kim Joo-Hun, 2007).

There are also ideological and policy differences in this matter among the various groups in Korea. While the majority of the neo-liberals in Korea claim that all these efforts are inefficient and amount to state interventionism, the pro-interventionists argue that the government needs to play a more active coordinating role in the transition. However, the changes in actual practices are not always followed by the changes in the formal legal

⁵ Wong provides very specific mechanisms about how the government's industrial policies have changed especially referring to bio-tech industries (Wong, 2004).

institutions. In other words, the Korean production regime reveals an interesting gap between the actual practices and the formal institutional changes.

2. Financial System: A Radical Change toward a Liberal Model

The most important institutional features of the previous developmental state (or production regime) were tight control of the financial sector by the state, large conglomerate-based industrialization, and concentrated authority in one economic agency (the Economic Planning Board) to plan and coordinate the industrialization process.

However, it is important to note that in Korea economic and financial liberalization began under an authoritarian government prior to democratization. The HCI drive was destined to create significant changes in the state-society relationship. The economic crisis of 1979-1980 was caused by excessive HCI investments during global economic recession. Recognizing this, the “liberal” faction in the powerful economic bureaucracy (the EPB) from the late 1970s (Choi, 1987) began to initiate a project of a gradual economic liberalization. In fact, this became an origin of the neo-liberalism in Korea.

The subsequent Chun Doo Hwan regime allied itself with neo-liberal bureaucrats following the IMF loan agreements and implemented structural adjustment policies, which were strong austerity programs aimed primarily at inflation (Woo, 1991). Thus the demands of the popular classes were managed with the state’s harsh repression. This structural adjustment process along with the rise of liberal bureaucrats within the economic bureaucracy initiated a series of institutional changes that signaled the start of a neo-liberal offensive against the developmental state. However, developmentalism firmly established during the past decade still remained the overarching ideology of the regime and its practices. Thus, despite certain liberalizations that occurred during the 1980s, the system remained a tightly monitored one by the state until the early 1990s (Chang, 1998 and Chang, Park, and Yoo, 1998, Weiss, 1999; Wade, 1998).

In fact, it was the Kim Young Sam government, the first civilian government that began a policy of accelerated economic liberalization and ‘globalization’, with far reaching implications for today. The democracy in transition based on the conservative ruling coalition also critically affected the Kim Young Sam government’s political choice of globalization and financial liberalization. The transition to civilian government was made through compromises among the conservative political elites. The Kim Young Sam ruling block needed to show its

significance by dismantling the pathologies of the authoritarian developmental state and replace that with a liberal democratic state. Since the join of the OECD membership, the government also radically deregulated the financial sector. This entailed external opening to more direct inflow of foreign capital, as well as a general reorganization of financial services. The merchant banks were increasingly licensed, but the government could not monitor the foreign borrowings through these merchant banks. In addition, exchange rate management failed miserably.

The *chaebols* became more and more independent of the government, as they gained direct access to the international capital market and acquired controlling stakes in certain minor regional banks (ownership of large national banks were subject to strict ceilings) and non-bank financial institutions such as merchant banks. With their increasing financial independence, the *chaebols* had become more aggressive recently even calling for withdrawal of government from the business sector. This allowed some *chaebols* to invest in certain manufacturing industries without carefully considering long-run viability. The best examples were *Samsung's* entry into the auto manufacturing industry and the *Hanbo's* entry into the steel industry.

These factors drove Korea into the financial crisis in 1997. With its power to coordinate business investments undermined, the state could not maintain its capacity to carry out economic readjustment programs. Consequently, democratization under the liberal-oriented conservative ruling coalition reduced the autonomy of the state from society, or more concretely, it failed to insulate the state from social influences. This radical financial liberalization meant an abandonment of the 'developmental state' model and its replacement with the liberal democratic state based on competitive capitalism.

The underlying cause of the financial crisis was the radical financial liberalization and abolition of industrial policy, which controlled industrial investments and capital flows. In other words, this was the dismantling of the institutional mechanism through which the state controlled the economic sector. Of course, the problems that had persisted throughout the developmental state, which included corruption, opaqueness, and moral hazards of business, were also detrimental to opening the economy to capital movements since that made it more vulnerable to such problems.⁶

⁶ Many commentators argued that the financial crisis in Korea was caused by the fundamental institutional deficiencies of the Korean economy, which encouraged inefficiencies and excesses by protecting investors from the adverse consequences of their decisions (Krugman, 1998). It might be true that the crisis was largely the result of a mixture of the premature and ill-managed financial liberalization and instability within the

By means of the structural adjustment loans, the IMF demanded far-reaching reforms to the financial and corporate sectors as the core of its reform package. First, the government spent ₩64 trillion to clean up non-performing loans and recapitalize viable financial institutions and deposit repayments in the initial period of the financial reforms. As of 2000, the government had used a total ₩126 trillion (Mail Kyungje, March 11, 2001). Second, the government also implemented regulatory reforms in the banking sector to increase transparency and open the sector to foreign capital. The government created the Financial Supervisory Commission (FSC) in April 1998, a new powerful regulatory agency to preside over financial and corporate reforms. Thus banking regulation moved much closer to international standards as set forth by the Basle Committee (OECD, 2000). Third, the role of the central bank was redefined as fundamentally monetary and relatively independent compared with past practices. The Roh Moo-hyun government continued to follow this basic line of reforms in the banking and financial sectors.

As a result of these financial reforms and economic liberalization, the government lost the traditional instrument of the developmental state to control domestic industries' investments. Until recently most domestic banks were privatized and often bought up by foreign investors except the *Woori* bank at the national level and a few of small local banks.⁷ Consequently, the traditional role of the banking sector as a pipeline of capital to strategic industries--so called 'relational finance'--has been significantly reduced. The banking sector now relies more on household lending and real estate loans including various financial service fees as the main sources for profits.⁸ Therefore, the financial system in Korea became much closer to the Liberal model.

Meanwhile, criticisms about the extent of reforms to the banking sector have emerged, especially regarding the rules that have led to more widespread ownership by foreign investors and the government's abandonment of relational finance for the domestic business sector. It is because even newly emerging and internationally competitive SME sectors still lack stable financial sources that could be counted on in the past. Although these ideas are emerging from the progressive groups and professionals, even within the financial sector, they are not gaining major political support as a public agenda.

international financial market (Stiglitz, 1998; Radelet and Sachs, 1998).

⁷ According to the Bank of Korea, the combined foreign ownership share of the Korean commercial banks rose from 8.5% in 1997 to 27% in 2002 and to 59% in September 2004. For example, the foreign ownership of the *Kookmin* bank, one of the largest domestic banks, was 71.69% in 2004.

⁸ Since the financial crisis, the amount of the loans per GDP by the banking and non-banking sectors to the household has increased, while the amount to the business sector has decreased (Cho, 2006).

However, it is clear that the open economy and the reforms of the financial market are now directly and indirectly affecting the business investment patterns, corporate governance, employment practice, and consequently the labor market toward more or less a liberal way.

3. Corporate Governance

In general, the issue and problem of corporate governance generally focus on the ownership structure. However, from the perspective of institutional complementarities in production and welfare regimes, as Aoki argues, what is more important is the governing structure and institutional rules for the coordination of financial investment and human resources (Aoki, 2001 and 2006).

As we have seen before, the state-led heavy industrialization strategy has transformed the Korean industrial structure into a large-business group dominant one. In this context, the corporate governance of the large-business groups has critically affected over the investment decisions, labor relations, and other important institutional domains of the production regime.

Before the democratization in the middle of 1980s, the corporate governance structure can be called as a ‘high-debt model based on the banks’ (Wade, 1999). During the early industrialization period, the state controlled investment decisions through the state-owned banks and, in this sense, a relational governance structure, although the governance structure was a family ownership. This is different from that of the relational corporate governance in Germany and Japan in which banks and businesses have mutually supportive long-term relationship in providing capitals and monitoring the businesses’ investments. This is a typical case for so-called ‘the stake-holder capitalism’. But in Korea, labor has been completely excluded in the management. In this sense, the state was a main coordinator in providing necessary capital and monitoring the investments and performances, and even controlling the labor relations. However, this dominant state power over the *chaebols* is gradually declined since the *chaebols*’ increasing influences over the economic performance as a result of the state driven HCI. In particular, since the democratization, the state power was gradually weakened. During the Kim Young-sam government, which was the first civilian conservative democratic force, important factors for the *chaebols*’ power are the far reaching liberalization and deregulation of Korean economy, the close relationship with the

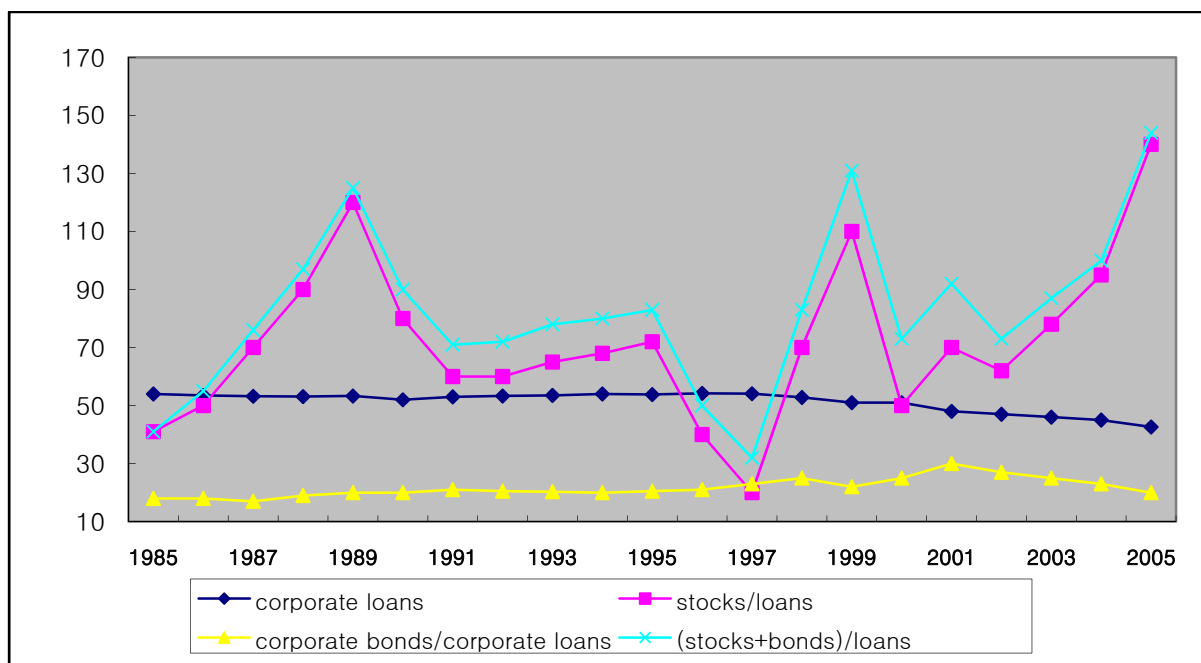
political elites, and the controlling of the commercial banks by the *chaebols*.

The problematic issue of the family owned corporate governance over the economy was raised after the IMF financial crisis because the main cause of the financial crisis was the *chaebols*' over-investments without either inside or outside monitoring mechanism. As a result of the reforms of the high-debt and overinvested businesses, nearly half of the 30 largest business groups or *chaebols* have disappeared since the crisis, suggesting that "too big to fail" is no longer valid. For the manufacturing sector as a whole, the average debt to equity ratio has fallen from almost 400% in 1997 to around 100% today (OECD, 2005). Consequently, the remaining *chaebols* have significantly improved their balance sheets in the context of an improved corporate governance framework.

There are three implications as a result of the corporate sector reforms since the financial crisis. Today, the *chaebols* no longer rely heavily on the banking sector as a capital financing source since the debt ratio significantly reduced. They increasingly resort to the stock and bond markets with a high level of cash holding. Thus, there is now no direct controlling instrument for the state to direct their investments. Second, in the past Korea achieved fast economic growth through the stable provision of finance/capital to targeted business groups and industries with high debt ratios. However, since the crisis, this is no longer possible. Although businesses generally have become financially healthy, the capital investment rate by businesses is now conspicuously low due to the increased uncertainties of the domestic and international economies, which implies a low growth rate with less job creation and lower domestic consumption (Cho, 2006, Chang, 2006). Third, in response to the increased market uncertainties, business investments are becoming more short-term based and the number of irregular workers is rapidly increasing. In sum, the changes in the financial and corporate sectors are now transforming the Korean economy into being much closer to those in the liberal market economy.

<Figure 5> shows the capital sources of large business groups. Since the financial gradual liberalization in the 1980s, the portion of banking loan has been gradually declined, while the main capital source became the reliance on the stocks.

<Figure 5> Capital Composition of the Large Business groups (%)



Lee, (2005).

Corporate governance reform has important political ramifications for the future of the state-society relationship in Korea. The successful industrialization during the 1970s had been based on the close relationship between the state and big businesses. Today the democratization of concentrated economic power is regarded as the most important condition for the transition to participatory or social democracy. Therefore, the enhancement of transparency and accountability in corporate governance of the *chaebols* and the regulation of their concentrated economic power are very crucial for preventing corruptive alliances with oligarchic political and bureaucratic elites.

Given the problems with corporate governance, the Korea Fair Trade Commission (KFTC), a strong regulatory agency in Korea, imposes a series of regulations on the firms affiliated with large business groups. In particular, the significant regulations were to limit the total amount of shareholding in other domestic companies and cross-shareholding within the groups, regulate loan guarantees, prevents financial affiliates from voting shares of their holdings, and watch “undue” transactions within a group (OECD, 2005). The voting rights of financial units owned by *chaebols* with asset exceeding ₩2 trillion will be limited from 30% to 15% by 2008. In 2004, the KFTC announced a roadmap that would allow the *chaebols* to graduate from the 25% share holding ceiling by meeting one of four conditions: i) an excellent internal monitoring system; ii) a narrow gap between cash flows and voting rights; iii) an uncomplicated shareholding structure and having five or less affiliates; and iv)

adopting a holding company structure (OECD, 2005).⁹ However, the international competitiveness of the Korean economy still depends on the economic viability of the *chaebol* groups given their economic dominance within the national economy. Thus, it is not easy for the government to push the corporate governance reform too far in spite of all the formal regulations.

Another critical issue was the relationship between the *chaebols* and the financial institutions. Before the financial crisis, the major *chaebols* were able to directly control non-banking financial institutions, which was the result of the financial liberalization started under the Roh Tae-woo government and a crucial cause for the financial crisis. Therefore, the government made the regulations to prevent domestic non-financial firms from holding more than a 5 percent stake in any financial company to deter *chaebols* from controlling financial organizations.

While these reforms and regulations contributed to constraining the *chaebols'* irrational behaviors and market power, foreign investors began to influence the management of the Korean companies as their share in the Korean stock market rapidly increased. In this milieu, domestic *chaebol* owners began to be seriously concerned with the protection of their ownership from foreign mergers and acquisitions.

For the reform of the corporate governance system, there have been interesting political actions from the civil movement organizations such as the People's Solidarity of Participatory Democracy (PSPD). The PSPD played an important role in awakening the Korean people to problems within the *chaebols'* governance structure. The PSPD has long struggled to reform the *chaebols'* family-based governance structure and protect minority shareholders. Civil society's struggle against the economic power of the *chaebols* can be a significant advance for participatory and social democracies, but their solutions are based too much on the neo-liberal idea of the corporate governance.

Meanwhile a movement against market liberalization and a Western-style corporate governance system has emerged from some minor progressive groups. In this milieu, there have been very interesting controversies about the role of the *chaebols* and the appropriate corporate governance system in the future of the Korean economy in terms of its competitiveness in the world market and sustained growth in the future. A majority of reformers have persistently argued for dismantling the family-based ownership and the

⁹ Of the 18 large business groups, four public-sector groups and five private-sector *chaebol* have met one of these criteria thus far.

conglomerate business structure, protecting minority stock holder rights, and improving transparency of business transactions.

However, some progressive academics, professionals and activists argue that diversified, large business structures are inevitable, lead to sustained economic competitiveness and growth, and need to be protected from hostile takeovers from foreign investors and firms (Chang, 2006).¹⁰ They argue that a grand class compromise, a social pact, is required based on fair distribution and employment stability from the labor side and business competitiveness and ownership stability from the business side. This social contract has been a basic model of the CMEs in the advanced welfare states in Europe. However, this idea did not gain much traction or political support from the public because the predominant corruptive relationships between the *chaebols*, politicians, and the government have been widely perceived as a serious pathology of the past developmental state. As a result, the idea of Western-style corporate governance began to dominate public discourse in Korea.

It should be noted that there is a critical difference between the demand for transparency and keeping business and government at arm's length. In other words, the requirement for transparency does not necessarily mean business and government cannot closely coordinate some activities. This would be the major difference between share-holder and stake-holder capitalism. As mentioned before, the cooperative relationship between business, labor, and the state forms an important institutional base for the international competitiveness of the CMEs in Europe and Japan. In order for Korea to move to a consensus-based CME and the democratization toward a social democracy, the real question is whether Korean politics and society will be able to institutionalize the social pact based on the consensus between business and labor. Thus this issue is closely related with domestic politics, that is, power relations and the nature of the ruling coalition.

Recently, there has been another interesting phenomenon that emerged in relation to the financial system and corporate governance, on the one hand, and social welfare such as the pension program, on the other. A pension program which has been regarded as an important institutional linkage between production and welfare regimes such countries as

¹⁰ Some progressive professors and researchers in universities and research institutes, and activists in the labor unions and various NGOs organized an research and action group called 'Alternative Policy Forum' with a goal of developing more practical alternative theories and policies for changing Korean society into a 'social democratic' type of the welfare state. There were interesting debates on the *chaebol's* corporate governance reforms between professionals and activists in the PSPD pursuing the neo-liberal line of corporate governance (a representative figure is Ha-sung Chang) and this group.

German and Japan from the view of the VOC.¹¹ As the pension program started in 1988 in Korea has grown large enough to affect the financial market and the macro economy, the public agenda has been raised about how this growing pension fund should be used, that is, whether this fund can stabilize the liberalized financial market and play a certain role in protecting the domestic banks and large business groups from mergers and acquisitions by the foreign capital.¹²

As the result of a series of the reforms in the financial and corporate sectors, the Korean economy now appears to be heading for neo-liberal capitalism in many aspects. However, as a key question for the characterization of the Korean production regime, the issues of corporate governance are still uncertain. What remains clear is that the *chaebol*-dominated economic structure will continue to play a significant role in shaping the Korean economy, social welfare, and politics by affecting the various elements of the Korean production regime such as labor relations, employment practices, wage determination, skill formation, and so on. Thus, more specific analyses on these issues from a comparative perspective needs to be done and will be crucial to understanding the changing welfare capitalism in the future.

4. Labor Market, Labor Relations, and Wage Bargaining

The labor market structure and labor relations are crucial institutional domains that link production and welfare regimes more directly than any other institutions in the production regime. Their formation and change also have political components. The western democratic corporatist countries with open economies have made wage moderations with the consensus between business and labor for the stabilization of the macro economy and their industries' competitiveness in the world market (Iversen, Pontusson, and Soskice, 2000). Their labor organizations and wage-setting institutions were either national- or industry-based. This non-market coordination based on the political consensus among wage, employment, the macro economy, and welfare has been the core mechanism of the CMEs.

What kind of labor relation and wage-setting system has Korea developed for the

¹¹ This issue has been an important aspect regarding the linkage of the production and welfare regimes from the VoC perspectives. Some scholars identified these linkages from the cases of German and Japan (see, Estevez-Abe, 2001, Manow, 2001).

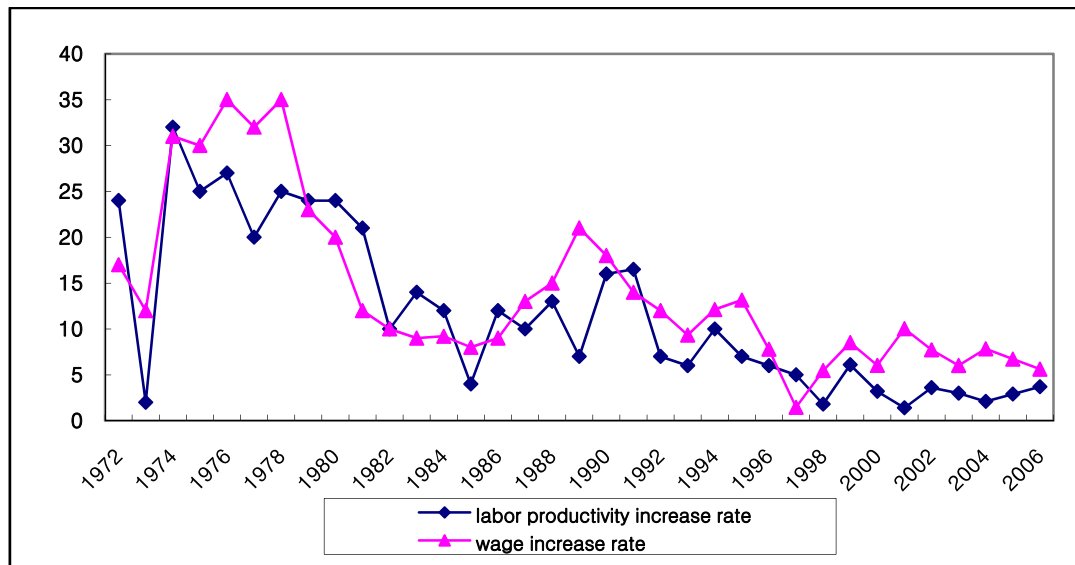
¹² The national Pension Fund amounted to 185 trillion won (23% of GDP) in October 2006 and is projected to increase nine-fold over the next 30 years. Around 91% of the Fund is now invested in bonds, with government bonds accounting for almost half of this category. Investment in equities is much less at 8% of the Fund.

coordination of economy? The Korean labor market during the early industrialization period was more or less homogenous, not seriously segmented than these days due to the continuing job growth and less complicated industrial structure and skill needs (Chung, 2006). The dualist labor market began to gradually emerge as the heavy-chemical industrialization (HCI) during the 1970s saturated the skilled labor market and the large business needed to secure them. This resulted in the gaps in wages and corporate welfare between the large business and the SME sectors, and between the organized and non-organized sectors.

The labor organizations during the HCI were industry-based. The military government during the 1960-1963 organized the industry-based labor union for the easy control of the labor by incorporating the labor leaders, but the actual behaviors were usually company-based due to the state's tight control of the central union organizations. Outside of the state corporatist control, democratic labor movements occurred. The corporate unionism that today has heavily affected the labor relations and labor movement was established in the early 1980s by the Chun Doo-whan government. The result was a further decentralized, fragmented, and atomized labor movement under the harsh repression of the Chung government. During the HCI and before the democratization, wage control was made by a mix of the state regulation and market mechanism. The state annually suggested wage-guidelines for business and labor, but the wages determined in the large business groups led the wage determination. There was no attempt to the corporatist wage moderation mechanism shown by the typical CMEs.

As we can see, during the HCI period, the saturated labor market pushed the wage sharply above the productivity. Then during the structural adjustment period during first half part of the 1980s, the state repressed wages. Since the democratization, the wage increase rate has been mostly a little above the productivity increase rate.

<Figure 6> Wage increase pattern in Korea (%)



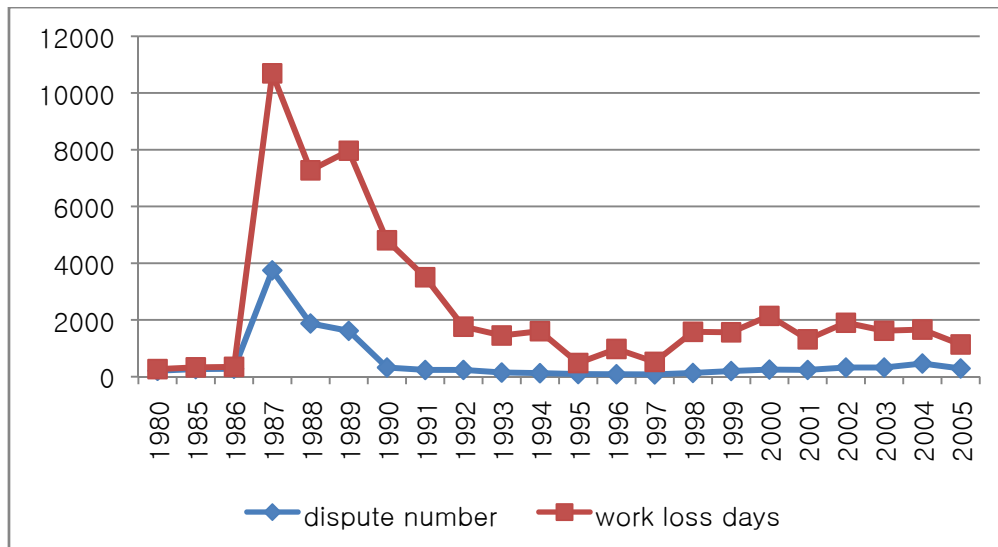
Source: Labor Statistics, Korea Labor Institute.

Matching with the argument of the production regime theory, the development of the social insurance-based developmental welfare regime in Korea was not a result of the labor movement, but a consequence of the state's strategic policy in an implicit coalition with the large business sector, given the priority of the mobilization of the economic resources for the growth first strategy and conservative fiscal structure toward social welfare (Chung, 2006).¹³ The labor movement during the past industrialization in Korea mainly focused on the worker's rights, impending wage increases, and the improvement of working environment under the harsh repression by the state. The corporate labor unionism based on the large business groups established under the authoritarian regime became a significant institutional barrier to seeking a solidarity of labor movement as well as any attempt for corporatist coordination for the various economic and welfare issues including wage-bargaining.

The democratization in the late 1980s became a historical conjuncture in the changes in labor relation, labor market structure, the product strategy, and skill formation in Korea. The labor movement since the democratization had not attempted to reorganize from the corporate unionism to the industrial one. As soon as the repressiveness of the state was relieved, the labor disputes sky-rocketed and then decreased (see <Figure 7>).

¹³ As argued in Chung (2006), for example, the industrial accident compensation (work injury) insurance program in 1964 was in a sense a preemptory social protection program for the core industrial workers when Korea had just started its exported-oriented industrialization. Since then, the coverage of this program had been gradually expanded. The medical insurance program implemented in 1977 was as a result of the state-business coalition.

<Figure7> Labor Dispute Trend in Korea

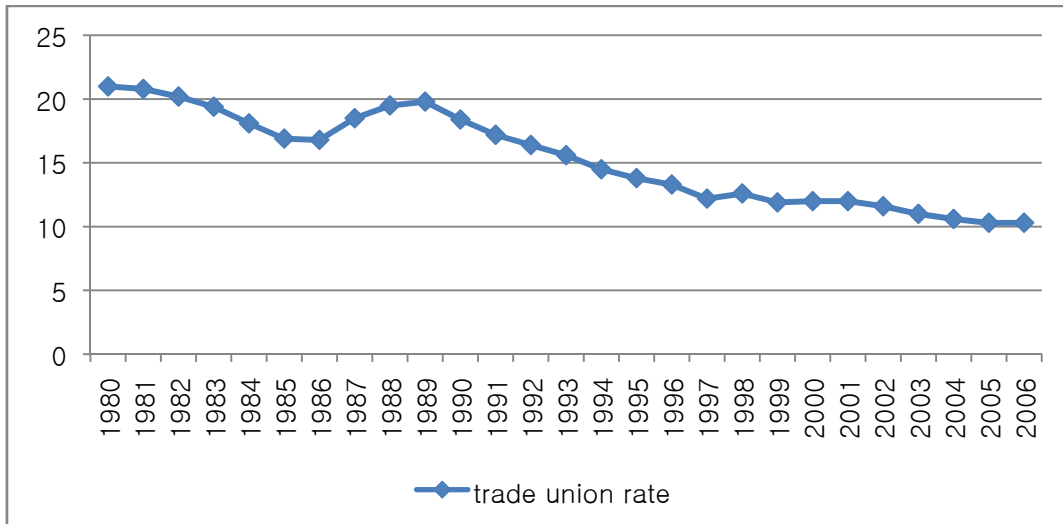


Source: Labor Statistics, Korea Labor Institute.

Labor movement in Korea has been mainly led by the large-business trade union. As we can see in <Figure 8>, the labor organizing rate in Korea was gradually declining. Right after the democratization the trade union rate rose again up to 20% in 1989, then the rate has gradually declined to 10% in the recent year. Except the moderate size of the SMEs in the manufacturing area, the most SMEs' workers are not organized. Although the size of the organized labor is very small, the power of labor movement was very strong because a few of strong labor organizations in the large-business manufacturing sector such as automobile, machinery, and ship-building are leading the overall labor movement and wage-bargaining.

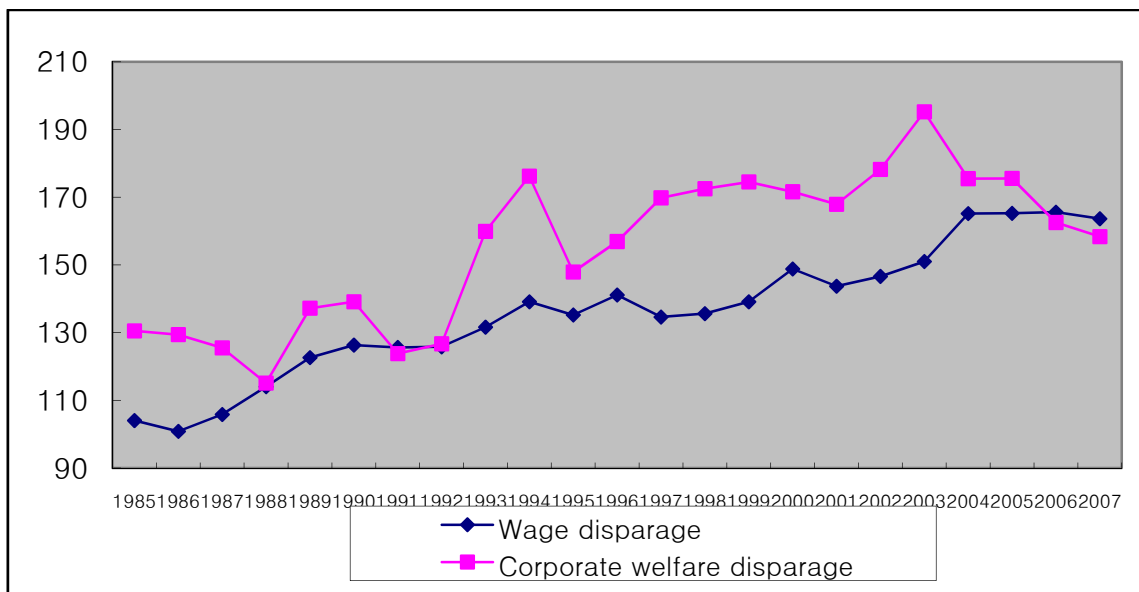
In particular, the early democratization intensified the dualist labor market. Coinciding with the saturated labor market, the rigidity of the internal labor market had been also strengthened. Since the democratization, the wage bargaining was led by the large-business corporate labor unions. They are in a sense a patter setter in wage determination in Korea. This mechanism of wage determination has affected the various areas of the production and welfare regimes. First of all, it widened the gap in wages and corporate welfare as well as employment security between the large corporations and the SMEs. This became an institutional base for the recent polarization in the labor market, wage, and employment pattern.

<Figure 8> Labor Union Density



Source: Labor Statistics, Korea Labor Institute.

<Figure 9> Disparages in Wage and Corporate Welfare between large- and small and medium-size Firms (thousand won)



Source: Labor Statistics, Korea Labor Institute

Dualistic labor market structure and corporate unionism aggravated the bipolarization within the working class. <Figure 9> shows the trend of disparages in wage and corporate welfare between large- and small and medium firms. Overall trends continue to be widening in both areas. The wages have been more or less moderated by the government's efforts. But disparage in corporate welfares increasingly widening because the large business firms need to keep high-skilled workers and the labor unionism in those firms are very strong.

The financial crisis in 1999 became another historical turning point in the labor

relations. Based on the previous institutional features, the comprehensive neo-liberal reforms critically affected the changes in the labor market and labor relations. The basic goal of the labor market reform under the Kim Dae Jung government was to further increase the labor market flexibility for the swift economic structural adjustment. Thus the Kim Dae Jung government, being supported by the organized labor, opted for a corporatist strategy to legalize the layoff by establishing tri-partite committee.

In fact, the smooth transition to labor market flexibility was made possible with the complementary institution of a well functioning of social safety-net. However, the previous 'developmental welfare regime' based on the insurance program provided a very limited protection for workers, especially for income and unemployment protection. While the blue and white-color workers in the large business sector benefited doubly from the major insurance programs and corporate welfare, the workers and the marginalized had been excluded from both welfare benefits (Chung, 2006). This developmental welfare regime was only able to make a supplementary complementarity when the economy created jobs due to the high growth rate.

The rapidly increased economic volatilities resulting from the neo-liberal economic reforms since the financial crisis have led businesses to favor the short-term profits rather than long-term growth. This subsequently caused a rapid rise in irregular workers and the change in employment practices from a relatively life-long employment with job security to short-term and career based employment resulting in high job insecurity in the labor market. In this process the irregular workers sharply increased even within the same firms. But, as we will see later, the Kim Dae Jung government's 'Productive Welfare' reforms was not sufficient enough to relieve these problems. Therefore, the rigidities in the internal labor market led by the organized union were further intensified.

Another significant phenomenon in the labor market as a consequence of the openness of the Korean economy and the various neo-liberal reforms since the financial crisis is the hierarchically intensified subcontract relationship. As I will explain in the next, the multi-tiered subcontract relationships also multi-layered labor market and intensified the internal labor market based on the company-based organized labor and the unorganized irregular workers.

In this sense, there are two possible ways to make the social welfare regime institutional complementarities with the production regime under globalization and the democratization. However, this changing regime will depend upon the political ruling

coalition and the power struggles between business and labor rather than depending on a response toward equilibrium.

First, if the changes in the production regime continuously follow the neo-liberal line and the conservative ruling coalition is maintained, the welfare regime will gradually change to a more or less liberal path in which selective programs for the poor and marginalized such as the public assistant programs with emphasis on market principled work-fare will develop.

Alternatively a consensus-based coordinating mechanism by which the improving coverage of the social safety net and job security for non-regular workers at the expense of relaxed employment protection and the moderated wage grow for regular workers in unionized sectors will enhance flexibility and reduce labor market dualism. However, these solutions are not possible without a wide range of political compromises between organized and unorganized labor as well as between business and labor.

5. Product Market Strategy, Production System, and Skill Formation

One of the important factors contributed to the successful industrialization in the East Asian countries has been known as the provision of cheap labor force with good quality through the state's control over the education and vocational training system. The Korean state not only centralized the control over the education system in order to develop a strong sense of national unity in the nation-building process, but also made the education and vocational training system closely articulated to industrial policies.

The most important institutional spheres in the production regime that critically shape the welfare system and supposedly have significant institutional complementarities are the relationship among skill formation (vocational and education system), labor market structure, industrial relations, and corporate governance (Estebez- Abe, Iversen, and Soskice, 2001; Mares, 2001; Iversen, 2005).

When Korea started its active industrialization since the 1960s, the world market situation and the production technology were different from those of the previous late industrialized countries such as German and Japan. Basically Korea followed the Japanese strategy as an isomorphism. Historically, the late industrialized countries based on the CMEs developed skill formation system based either on the organized craftsmanship as in the dual system in Germany or on the company-based training system as in Japan (Thelen, 2003). As the next generation of the late industrializer, Korea has not enough time and the vocational

education system to raise skilled craftsmanship workers. When Korea started industrialization, the production technology and system had already been based on the Fordist mass production.

In this context, Amsden suggests an interesting explanation about the skill formation in Korea (1989). She emphasizes the technology learning strategy that Korean state and large businesses adopted to penetrate the world market. Due to the high level of education with abundant cheap labor in Korea, high-educated engineers could be supplied. By assigning high-quality managers to the shopfloor and inspire initiative on the part of such managers to develop the skills of the work force and to improve process performance. Otherwise the gap in productive levels with leading firms in advanced countries will not be bridged while the advantage in wage levels narrows.

Nonetheless, the large business firms needed high-skilled workers at the factory level to compete with other firms. They have strong incentives to preempt the high-educated or skilled labor by protecting their employment and to invest their education and training for acquiring either firm-specific or industry-specific skills. In other words, unless the state provides the high level of the social protection for the high skilled workers, the employers' incentive to keep the firm-specific high-skilled workers in the saturation of skilled labor in the labor market becomes a crucial driving force to develop corporate welfare.

In order to supply the skilled workers necessary for the heavy-chemical industrialization during the 1970s, the state quickly established the vocational high schools and the public vocational and training institutions. This strategy was effective in the sense that the technological level of the production at the time was a low-skilled Fordist mass production.

Given the absence of the original technologies of the products and the high-skilled craftsmanship workers, the catch-up strategy that the Korean manufacturers adopted was to construct the efficient assembly lines of the final product by borrowing and learning the foreign production technologies. Therefore, the competitive advantage for the production strategy was to make an efficient assembly line with innovation and cheap labor. From the middle of 1970s when the HCI reached at a certain stage, the labor market became tightened for the high-skilled and the dual labor market structure began to form. The dual labor market was also reinforced by the corporate-based union and labor movement in the large industries.

The development of corporate welfare in Korea was not purely a result of the employers' voluntaristic response to the labor market. The state also encouraged the business to provide the corporate welfare and often regulated it by law because the state's had no

intention to increase the state welfare unless necessary (Choi, 1992; Song, 1992). Instead, the state intentionally induced the employers to provide corporate welfare for the control of labor by giving them some incentives such as tax concessions and subsidies. In a sense, the developmental pattern of corporate welfare in Korea was similar with that in the early period of Japan (Shinkawa and Pempel, 1996). However the skill formation system, the lifelong employment, and the level of corporate welfare in Korea were not so much sophisticated and highly developed as those in Japan.¹⁴ Nonetheless, a very distinctive feature of the East Asian developmental welfare regime would be a mix of social insurance programs and the regulated corporate welfare in the area of large business sector. This means that the state mainly provided the regulated public welfare because it allowed the promotion of industrialization and the control of the labor without the state's financial burden.

Technological change to allow the use of robots and computers for the production automation has transformed all industries. Therefore export-oriented large manufacturing firms mane more capital intensive production line with more complex in terms of the number of stages in the production process or the difficulty of process control. The result has been a far greater range among firms than in previous periods with respect to size, integration, capital intensity, and the employment of managers. This appears to have encouraged the emergence of subcontracting systems.

As we have discussed, democratization since the 1987 intensified the corporate labor unionism and the confrontational labor relations. This affected the businesses' production strategy and skill formation. To avoid the harsh confrontation with the organized labor, the Korean manufacturers adopted high level of automation strategy in order to reduce the employment and improve the labor productivity. Instead they raised R&D expenditures for the automation for efficient production line. Thus, the production system in Korea mainly relied on the employment and skill saving system. Thus, as we have seen above <Figure 2>, the employment rate of manufacturing sector began to gradually decline from the late 1980s. Since the 1990s, Korean industries began to be competitive in the IT industrial sector, which requires the high-level of general skills. This is coincided with the fact that the Korean education system provided high-level of university-level graduates.

While the Korean economy has been competitive in the traditional HCI industries

¹⁴ It is very difficult to obtain the specific comparative analysis about labor markets and skill formation in East Asian countries. Some research show that the job stability in Korea based on the average employment duration rate of the countries is quite low compared with that of Japan and even USA. The life-long employment in Korea is not fully institutionalized as in Japan (Jung and Cheon, 2004).

with very high efficient assembly production system, on the one hand, the IT industries arose as the next competitive industries. Given the Korean economy today reveals a very hybrid form of labor market structure and skill requirements. However, the SMEs in the areas of the part industries based on high-tech and skilled craftsmanship could not have developed because high craftsmanship skilled workers could not be supplied for the SMEs in high-valued part industries and micro-process mechanical machine industries. As we will see later, the hierarchical subcontracting system between large firms and SMEs could not provide the SMEs to develop original technologies and high skilled labor.

In sum, the Korea's product market strategy and skill formation system in the milieu of her position of the world market is also dualistic.

6. Inter-Firm Relations: Hierarchical Subcontract System

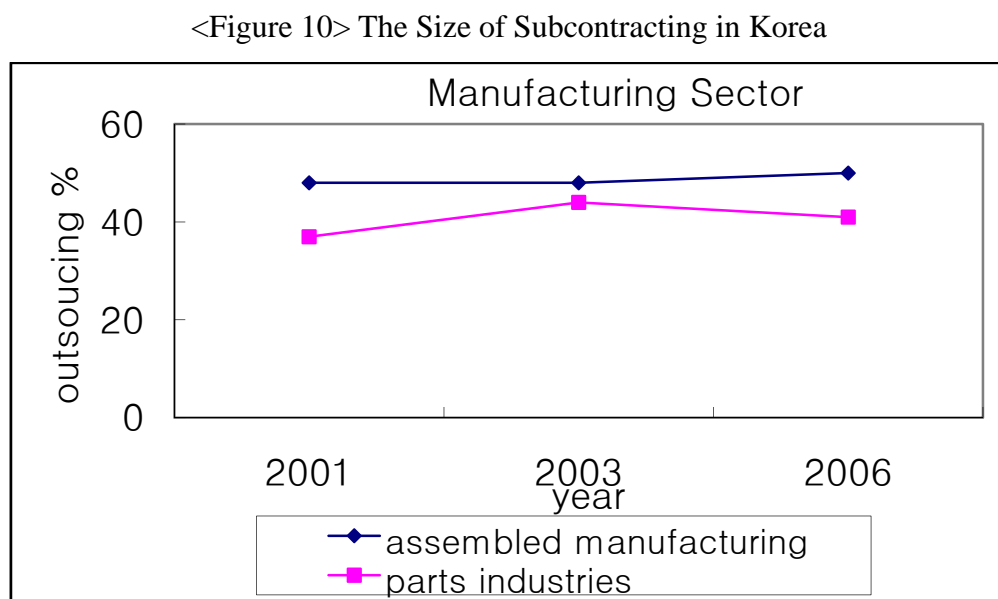
The industrial structure of the Korean economy has evolved as an export-oriented large-business based economy. The competitive advantage of the production system lies in the efficient manufacturing of innovative final products with low price.

Late industrialization requires sufficient output volumes by prime contractors to enable suppliers to specialize inputs. For example, in the automobile in Korea, the condition began to take hold in the 1980s, and a subcontracting system arose that was a microcosm of Korea's industrial economy. The system was hierarchical. The subcontracting system like those of other parts of Korea's economic system was more desirable from the viewpoint of economic growth and efficiency of late industrialization.

The state's industrial policy also emphasized this point. The major piece of legislation from the government to stimulate subcontracting came out in 1982, when global economic depression intensified competition from Japan. The Small and Medium-Industry Systemization Law appealed to the big businesses by empowering the Minister of Commerce and Industry to reserve certain industrial spheres for small- and medium-size subcontractors (Amsden, 1989; Park, 2007). The law also forbade prime contractors from swallowing up subcontractors through stock ownership. Additionally, the government undertook responsibility to provide more financial and tax incentives to enable subcontractors to modernize their factories and to acquire technical assistance. It introduced a scheme to reduce the risks they faced in commercializing new technologies. Finally, it provided guidelines on fair trade practices, for example, on the frequency of payments and the length of

subcontracting contracts. These guidelines were enforced by a large bureaucracy in the Economic Planning Board. Subcontracting surged ahead after 1982. In terms of growth and efficiency, however, Korea's subcontracting system has been an efficient vehicle by which to spread the progressive practices of the modern industrial enterprise to the remainder of the productive economy.

We do not have specific date for the growing pattern of the subcontracting system, <Figure 10> clearly shows a large portion of subcontracting system in the Korean industrial structure.



Agency of the SMEs. The SMEs statistics.

However, in terms of equality between big and small business, Korea's subcontracting system has been unilateral, not collateral like Japan's. As a consequence of prime contractors' operating procedures, the day-to-day working environment of subcontractors is stressed. As a consequence of prime contractors' market power, the profit margins of subcontractors are squeezed.

However, in Korea the lack of organized or mobilized small business interests delimited the qualitative development of this sector. Since the IMF crisis, the large businesses emphasized a global production and faced short-term based competitiveness as a consequence of the neo-liberal reforms. The large business began to use their subcontractors as a tool for price transfer as well as employment buffers by using its monopolizing power.

This hierarchical subcontract system, which has been an important element for the production system in Korea, has been further degraded since the financial crisis. The large

business firms began to utilize the various forms of subcontracts in the process of manufacturing. They often use the subcontractors inside of the factory by sharing some part of the assembly process. In this process, large portion of irregular workers is growing with low wages and less provision of the corporate welfare. This became a fundamental structural cause for the bi-polarization of the Korean economy in the areas of labor market, income, and corporate welfare.

Under the given confrontational labor relations and strong corporate unionism only to protect the insiders, a very rigid dual labor market has been formed; while the organized insiders enjoyed high wages, employment protection, and corporate welfare, the unorganized outsiders suffered from low wage, job instability and low corporate welfare. The large firms utilized the subcontract system to transfer the labor cost and manage the employment flexibility as the management and production strategies.

In other words, the subcontract system in Korea began to function a buffer zone for employment and wage coordination as a supplementary complementarities.

IV. Beyond Developmental Welfare Regime?: Continuing Regulatory Role of the State in Social Protection and Supplementary Complementarities to the Production Regime

1. Early Stage: the Basis of the Developmental Welfare regime

The early formation of the Korean welfare system during the 1960s was basically a political response by the military elites to enhance their legitimacy during the process of transitioning to civilian rule rather than the response to a serious economic need. Nonetheless, the basic framework that the military government established guided the subsequent development of the social security system. The Basic Law of Social Security System specifies self-help, work incentives, and a minimal level of government involvement in social welfare, all of which were symbolic manifestations of developmentalism in the Korean welfare system. Although two insurance programs (medical and work injury) were proposed in 1963, only the work injury insurance program was implemented, covering a selection of large industrial manufacturers. The launch of this program also revealed that the state had established the social security system in preparation for upcoming industrialization. The civil servants pension program was enacted in 1960. The military government then went on to implement the military pension program in 1963 and later the teachers' pension program in

1973. This pattern is commonly seen in nation-building process. This was clearly a common step found in the nation-building process to run the state apparatus by co-opting the core state elites.

Korea's industrialization strategy in the 1960s was based on labor-intensive industries, particularly those employing low-paid women workers. Wages remained low as a result of abundant labor supplies from rural areas. However, industrialization created enough jobs the excess labor supply. In this context, a social policy would have been extraneous and irrelevant.

2. Heavy-chemical Industrialization and the emergence of the developmental welfare regime

The Korean developmental state reached its peak with the heavy chemical industrialization (HCI) drive during the 1970s under the auspice of the highly authoritarian *Yushin* regime. During this period the government attempted to implement two major insurance programs: national pension program in 1973 and health insurance program in 1977. The pension program was not implemented due to the economic repression caused by the oil shock. The hidden intention for the pension program was a domestic capital mobilization with launching the HCI drive because the pension fund was expected to be a good source of domestic capital. But its implementation had been postponed due to the economic repression caused by the oil shock and the opposition of the business sector. Although the pension was not implemented, the intention showed how the state linked the social welfare program to the industrialization.

In fact, the political elites had been very reluctant to initiate and implement social welfare programs in this period. Nonetheless, the political economy of the HCI drive pushed the state to play a certain role in social welfare. The big push of the HCI quickly exhausted the skilled male workers and the labor market suffered the lack of the skilled labor. The large business sector needed to secure them and the health cost for their workers began to sharply increase. Under this situation the health insurance program was implemented from 1977, based on a close coalition between the state and the large business sector. Initially the health insurance covered the manufactures with more than 500 employees, which was the core workers in the HCI. The health insurance funds were organized along with the large firms and the large business association (the Federation of Korean Industries) ran the health insurance

programs. This organizational structure was corporatist, which were found in German and Japan.

Many scholars in social policy field tend to miss the macro-economic policies, which have been closely related with the institutional base of the welfare regime. The Korean government has maintained a position of conservative fiscal policy by making every effort to minimize the budget deficit. In addition, the basic principle of the macro-economic management has been the supply-sided rather than the Keynesian demand management that had been a driving force for the expansion of the welfare states in western industrialized countries. Interest rate and foreign exchange policies had been closely coordinated to promote the business investment and the export. This pattern has been commonly found in East Asian developmental states as later developers.

This principle of macro-economic management became a very crucial institutional factor that prevents the state from financing to social welfare policies. Many economists have evaluated that East Asian economic miracle was aided by the government's strict budget control (World Bank, 1993; Nam and Kim, 1997). The developmental states in East Asia tried to mobilize the economic resources and efficiently distribute the economic sector. Thus, the financing principle of the welfare programs usually stick to the user's charge base shown as social insurance programs in order to maintain the minimal cost of welfare, although some programs were inevitably financed by tax. This principle is related with the idea of developmentalism.

Social insurance programs were a modern form of welfare program in capitalist economy, which can protect a majority of workers and then later all citizens from major social risks. But social insurance programs were also very effective in reducing the state's financing role to minimal, because the entitlement is derived from the contribution of the insured. Thus, Japan, Korea, and Taiwan, which initiated a rapid industrialization based on manufacturing required skilled labor, implemented social insurance programs as their main welfare system.

3. Large business industrial Structure, Skill Formation, and Corporate Welfare: Emergence of Dualist Welfare System

One of the important factors contributed to the successful industrialization in the East Asian developmental state has been known as the provision of good quality of labor force due to the these countries. The state centralized control over the education system in order to develop a strong sense of national unity or nation building. Then the education system was closely articulated to trade and industrial policies which were to drive the process of industrialization.

The most important institutional spheres in the production regime that critically shape the welfare system will be skill formation (vocational and education system), labor market structure, and industrial relations. The saturation of skilled labor in the labor market and, at the same time, the business to secure the skilled labor for their improvement of productivity became crucial driving forces to develop the corporate welfare, unless the state or the business and labor coordinated in a certain way by socializing skill formation like the German case.

The HCI drive during the 1970s has critically changed the state and business relationship by consolidating the large business group industrial structure in Korea. The state quickly established the vocational high schools and the public vocational and training institutions organization in order to provide high skilled workers. This strategy was effective in the sense that the technological level of the production was a low-skilled Fordist mass production.

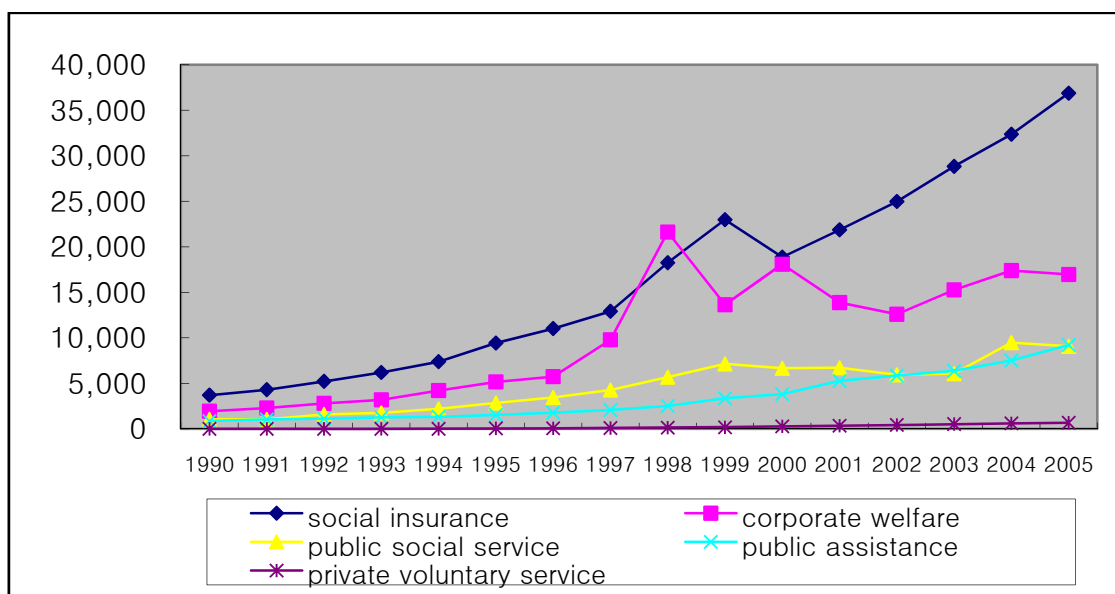
However, as the labor market became tightened as a consequence of the rapid industrialization, the large business firms in the heavy chemical industrial sector increasingly needed to secure high skilled workers and began to provide their own on-the-job training programs and corporate welfare. The development of corporate welfare in Korea began to rapidly increase when democratization started from the middle of 1980s. Given the low level of the state welfare and the tightened labor market for skilled workers at this time, the democratization loosened the state's control of labor unions, increasing the bargaining power of the large business unions. The large businesses chose the strategies to keep the skilled workers by providing on-the-job training, lifelong employment, and various corporate welfares.

However, the corporate welfare in Korea was not purely voluntaristic by the business sector. The state encouraged the corporate welfare and often regulated by law instead of the state's low welfare. At the same time, the state intentionally induced the employers to utilize the labor control via the regulated corporate welfare. This is very similar pattern with that in

Japan, although the skill formation, the lifelong employment system, and the level of corporate welfare are not so sophisticated as those in Japanese business sector.

<Figure 11> reveals the relative size of the welfare expenditure between public and private one. The corporate welfare expenditure is not so low, compared with the social insurance expenditure. Corporate welfare gradually increased and sharply rose during the financial crisis. This might be due to the retire payments for the fired people during the structural adjustment. Then corporate welfare has been stabilized.

<Figure 11> Comparison of Public and private welfare (1990-2005) (million won)



Ko and et al. (2007). P. 107.

As well known, the expansion of corporate welfare exacerbates the dualism in welfare regime. While the large business sector can maintain productivity and competitiveness, its cost turns to the unorganized sector of labor market by increasing low-wage irregular workers and the subcontracted small and medium firms. Thus, the labor of large business sector receive higher benefit from both public and private sectors, but the workers in small and medium business and the urban marginal sector get less low public benefits with poor corporate welfare, if any. If this dualism is widened, the sustainability and competitiveness of corporate welfare become suspected from a long- term perspective.

4. Democratization and the Expansion of the Developmental Welfare Regime

The over investment of the HCI by the Yushin regime resulted in a serious economic recession at the later period of 1970s. As a result, the Yushin regime collapsed with the assassination of the President Park Chung Hee. After the short period of democratization, another strong authoritarian government emerged. The Chun Doo-whan regime's historical task was to stabilize the economy through the tight austerity economic policies. Thus this period could not observe any significant the development of social welfare programs except for the gradual coverage expansion of the health insurance system. Instead, there were internal political struggles over the organizational reform of the health insurance funds.

Another critical timing of the expansion of social welfare policies happened with the democratization from the later part of the 1980s. In face of the strong opposition movement against the Chun Doo-whan regime's extension of the non-elected rule, the Chun government declared 'three welfare programs', which were the minimum wage law, the implementation of pension program from 1988, and the expansion of the coverage of the health insurance to the farmers and fisheries. Then newly elected Roh Tae woo government actually implemented the pension program in 1988 with the coverage of the firms with more than five employees and expanded the coverage of the health insurance to the urban self-employed in 1989, implying the universal coverage of the entire citizens.

After the severe austerity program, the Korean economy began to gain stability and enjoyed the most prosperous area and then the labor market became tightened, showing a skill mismatch sign. Responding to this, the government implemented the employment insurance program in 1995 with the coverage of the firms with more than 30 employees. The program structure of the employment insurance was very consistent with the nature of developmental welfare system like other insurance programs: the coverage included only the workers in the relatively stable work places with contribution abilities to the insurance; this program enforced the active labor market program and subsidized the on-the-job training cost of the large business sector.

Consequently, until the middle of the 1990s just before financial crisis occurred in 1997, Korea equipped four major insurance programs. Until then the public assistance program aided only unworkable people with very strict means test. Social service programs were far less developed. The government only subsidized the non-profit welfare service organizations with tight regulations. This unbalanced structure of social welfare programs was a typical feature of a developmental welfare regime in Korea.

<Table 1> the pre-crisis institutional features of the developmental welfare regime

Ideologies and functions	<ul style="list-style-type: none"> ● A strong developmental ideology deeply embedded in the welfare system as well as other social and political institutions ● Conservative ruling coalition between the state and business; the labor excluded or incorporated ● Subordination of social welfare policies to the industrialization and macro-economic policies ● Strong fiscal conservatism; public financing skewed to economic investment rather than welfare ● Employment-related or industrial achievement model/ benefits through work
Formal structure	<ul style="list-style-type: none"> ● Social insurance programs as a main welfare system with the state's minimal contribution to the fund ● Very strict provision in public assistance ● The least development of social services; the least state's direct provision of social services; instead the state subsidized and regulated non-profit service organizations, especially the state regulated and subsidized non-profit organizations in the area of education and health ● Focus on human capital development; especially education and vocational training ● Corporate welfare but different from the liberal model/initially the corporate welfare regulated or subsidized by the state
Effects	<ul style="list-style-type: none"> ● Minimal income protection/very low decommodification/ high stratification/strong emphasis on work incentives ● Dualism in the welfare system: high level of public and private benefits in the large business sector and low level of public and private benefits in the small and medium industrial sector and the social marginal sector

5. Financial Crisis and the Reforms of the Korean Welfare System: Beyond the Developmental Welfare regime?

The financial crisis in 1997 brought about massive unemployment, which reduced workers' income and quality of life. The unemployment rate skyrocketed from 2.2% in July 1994 to almost 8.5% in the early 1999. The manufacturing and construction sectors were especially hard hit. Anticipating the problem, the government immediately planned to expand the social safety net.

The government quickly expanded unemployment benefit coverage from businesses with 30 employees to 10, 5 in 1998 and finally all employees except temporary and part-time workers in 1999 and the massive. This means that unemployment benefits cover virtually all regularly employed workers. And the government has concentrated much on the expansion of

the various labor market programs including temporary work programs.

In addition to immediate measures against unemployment, the government expanded coverage of other social insurance programs to the marginal sector: the national pension program began to cover the entire public including the urban poor and the self-employed from 1999 on. The work injury compensation insurance program also expanded its coverage from businesses with 5 employees to all employees. The government attempted to reform the organizational structure of the insurance programs for improving administrative efficiency and the social integration function of social welfare policy. The first target was to unify the fragmented corporative system. The medical insurance program consisted of 142 insurance associations serving company employees and 227 regional insurance societies for the self-employed. In October 1998, the 227 regional insurance societies and the administration for public employees and teachers were integrated into a new authority called the National Health Insurance Corporation (NHIC). The National Health Insurance Act was passed in the National Assembly in January 1999. The remaining company-based associations were integrated into the NHIC from July 2000. The government even tried to unify four insurance programs on the organizational basis, but the attempt was soon aborted.

This coverage expansion to the self-employed in urban and rural areas under a unified insurance system is extraordinary even in comparison with the advanced welfare states of Europe in the sense that the coverage inclusion of the urban informal sector was administratively a very difficult task due to difficulties in collecting contributions.

The new public assistance program (the National Basic Security Law, NBSL) was legislated to provide poor people with a minimal level of income as a right whether or not they have the ability of work. This was a significant change in the Korean history of social welfare in that the notorious old Elizabethan type of public assistance program has now been replaced with a modern form of poverty relief program.

This series of social welfare reforms clearly show that the Korean state is expanding its role in social welfare under the pressures of globalization, as the compensation view argues. This is the opposite of the conventional neo-liberalist argument about shrinking social welfare under such pressures.

Later, the Kim Dae Jung government labeled its own social welfare reforms as 'productive welfarism'. This aimed at a productive contribution to the economy by increasing employment and protecting minimum level of living. The concept of the 'productive welfare state' originated within the Scandinavian model, especially the Swedish

model, where economic policy and social welfare policy are closely linked via the active labor market policy with the universal income protection of the people (Esping-Andersen, 1991). However, ‘productive welfare’ implemented in Korea appears to be closer to the neo-liberal idea of workfare welfarism rather than the Scandinavian productive welfare state.

In spite of the formal expansion in the coverage of major insurance programs and the introduction of a new social assistance program, the overall income support level is still very low because there was no reform measures for improving income protection except of the coverage expansion for the basic social risks and public assistance program. For example, medical insurance component does not have a sickness benefit, only covering part of necessary medical services. The old age pension program has not yet matured, so only a quarter of people receive benefits. The average pension currently amounts to two-thirds of the minimum wage. Unemployment benefits were received by only a small percentage of the unemployed due to strict regulation (OECD, 2000b). Furthermore, the public provision of social services, which is an important condition for the Scandinavian productive welfare, is very poor in Korea. In other words, the main feature of the social welfare system is a high level of commodification and a strong workfare nature. In sum, while the formal structure adopts a statist approach, the benefit structure is closer to the liberal model.

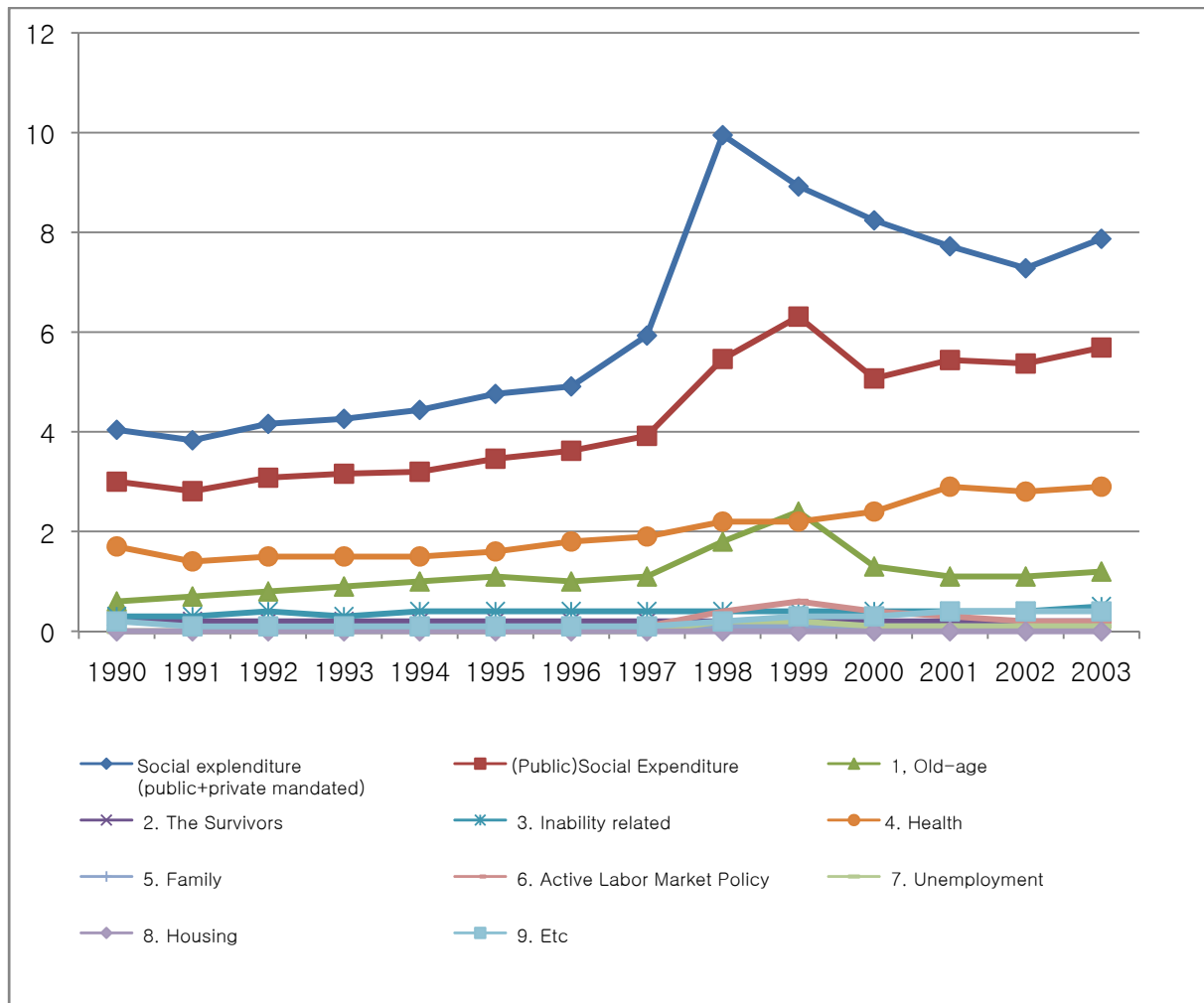
<Figure 12> shows the trend of the Korea’s public social expenditure according to the OECD criteria. Overall total social expenditure is gradually increasing, but still below 10% of GDP. During the financial crisis, the social expenditures sharply grew, but a few years after the crisis ended, the total social expenditure lowered. The main reason for the sharp rise was the increase of the mandated retirement expenditures. <Table 2> reveals that the Korea’s social expenditure is still very low compared with the other OECD countries.

<Table 2> Comparison of Social Expenditures (% of GDP) in OECD countries (2003)

OECD Agerage	Korea ¹⁾	Sweden	France	Germany	Denmark	United Kingdom	Netherlands	Japan	United States
21.83	9.09	31.85	29.08	28.40	27.80	21.43	21.38	18.39	16.59

Source: OECD, Social Expenditure Database, 2006.

<Figure 12> Trend of Public Social Expenditure in Korea (% of GDP)



Source: OECD, Social Expenditure Data.

Some might argue that the expansion of the social security system by this government is simply due to the Korean state lagging behind other nations. The government did not develop a sufficient social safety net because state-led industrialization emphasized economic growth over distribution. Thus, the recent expansion of the social safety net is the government's natural response to prevent social and political instabilities due to the economic crisis. However, it is important to ask why the government, which is attempting to create a more market conforming economy, chose a statist approach for the social safety net and a consensus-based labor relations.

This hybrid structure of the Korean social welfare system can be explained by the institutional legacy of the developmental state and the changing power of the state-society relationship since the Kim Dae Jung government started. In other words, productive welfarism is a current version of the "developmental welfarism" that the past developmental state created during the state-led industrialization. As shown above, the Korean welfare

system was an integral part of the state-led industrialization strategies. The basic structure of the Korean welfare system was made through the conservative bureaucratic approach with the developmentalist idea.

However, the attainment of political power by Kim Dae Jung, supported by the popular sector, has dramatically shifted the balance of power between the state-capital-labor relationships. As mentioned above, the economic crisis made this shift more plausible by weakening business and conservative group's power. Above all, the most interesting factor in the Korean context is that civic movement organizations retain a critical role in making and reforming social welfare policies. Since the democratization of the late 1980s, civil society in Korea was rapidly strengthening. In relation to the social welfare system, activists (especially PSDP activists) contributed to the basic shaping of the social welfare reform model under the idea of solidarity and protection for all. The PSDP has advocated for the reform of the old social assistance program by criticizing its dehumanizing nature. The social welfare reform movement was initiated by the PSDP. The government frequently consults with powerful civil movement organizations regarding the critical reform issues and policies related to the interests of a majority of citizens. This implies that democracy in Korea is transitioning from a formal state to participator one, at least in the area of social welfare.

However, in Korean society, the policy-makers and social elites are all subject to the developmentalist idea, which is that the social welfare program should not undermine the institutional base. The best example of this is revealed in the policy-making process of the National Basic Livelihood Security Law (the NBSL) (Ahn, 2000). Economic bureaucracy and conservative mass media and academia consistently opposed the NBSL in that it would undermine work incentives, in particular in those who have the ability to work. Even after the law passed, they are very cautious to keep benefit levels low.

In order for the current social welfare system to function for social integration with protection, the programs should be further reformed. This might require a greater power balance between the state and society and the deepening of democracy.

In other words, the Korean welfare regime has not been built to support the production system with a synergic complementarities like in the traditional CMEs. Instead, like a liberal welfare model, the Korean public welfare system has played a crucial role for the rapid industrialization by protecting initially the core workers in the large manufacturing sector and then the minimal social protection role against the major social risks of the ordinary citizens.

6. Roh Moo-hyun Government's Vision 2030 and Social Investment State

The election of Roh Moo-hyun as president was another important historical event in the developmental process of social welfare policy in Korea. With a marginal victory in spite of the revival of the conservative forces in the later part of the Kim Dae Jung government, progressive forces have barely held on to political power and been able to succeed to the major reform policies including the pro-welfare line of the productive welfare.

Due to the economic recession, deepening polarization, and rapidly rising youth unemployment at the time of the presidential election, there was a high expectation for further social welfare expansion and reforms. However, in its early period, the Roh Moo-hyun government not only had put its reform priority on the political agendas for a hegemonic strategy, but also confronted many other serious non-welfare challenges. Therefore, the Roh Moo-hyun government began to be engaged in its welfare reforms at its later period of office.

Being aware of its belated drive for the welfare reform and the significant demographic problems and the rapidly rising of new social risks, which can jeopardize the growth potential of the Korean economy, the Roh Moo-hyun government initiated a comprehensive reform plan with a long-term aim of gradually improving the existing social programs and while introducing new ones.

With this expected crisis of the future Korean economy, the Roh government envisioned Korea as a 'world trade country' and thus initiated a national strategy to improve the current status of the national economy and social welfare toward an advanced level. One way to accomplish this goal was a series of FTAs including the recent Korea-US one. At the same time, the idea of paradigmatic change in social welfare has emerged. President Roh claimed that the country's economy was in the process of transforming itself from input-led growth to an innovation-driven model. He emphasized that the most urgent issues to be addressed were the gap between big and small businesses, high-tech and traditional industries, regular and temporary workers, the capital and provincial regions, and high and low-income families.

The government announced the Vision 2030 in August of 2006.¹⁵ Projecting the

¹⁵ The Vision 2030 was made by the experts of 13 think tanks including the Korea Development Institute, the Korea Labor Institute, the Korea Institute for International Economic Policy, and the Samsung Economic

status of the Korea's economy and society in 2030, it is a comprehensive long-range development plan.¹⁶ The political rhetoric behind this plan is that Korea is shifting its growth strategy to be more balanced and equitable by putting greater emphasis on investment in human resources and the buildup of an advanced social welfare system to better cope with new challenges in the 21st century.¹⁷

The Roh Moo-hyun government also invented a new vision of the state, which is called 'Social Investment State' concentrating on human resource development as the future paradigm of the social welfare. This terminology and idea of the social investment has originated from Anthony Giddens' 'The Third Way' under the Blair government in UK, in which the future model of the welfare state is placed between the traditional Keynesian social democratic model and the work-fare oriented liberal model (Giddins, 1993).¹⁸

However, this vision and the idea of the social investment state did not gain much attention from the public and thus the political support from the majority of the people. The conservative parties and groups criticized the plan as radical and infeasible, but the leftist sides as still neo-liberal. Furthermore, the conservative mass media intentionally downgraded and disparaged the values of this plan and the concept of the social investment state. It was also criticized that this plan should have been initiated in the earlier in the tenure of the Roh government, thus the timing of the announcement was too late because the Roh government had already been discredited and had little power for its implementation. After being publicized, intensive debates about the appropriateness of the concept of welfare as social investment were made among some academics and the NGO activists. The ideological parallel without the consensus for developing specific action plans continued until the term of

Research Institute with professors of universities nationwide.

¹⁶ Korea's social expenditure as a percentage of GDP has grown to 8.6% in 2005 from 3.2 percent in the former President Kim Young Sam administration, but it is still around half that of the United States and Japan, and one third of Scandinavian countries. Vision 2030 aims to draw it up the level of the United States and Japan by 2020, and to the OECD average by 2030.

¹⁷ As policy goals, Vision 2030 lists three objectives: i) a dynamic and innovative economy, ii) a secure and equitable society, and iii) a stable and respected country.¹⁷ First, to achieve a dynamic and innovative economy, Vision 2030 proposes investment in education and enhancing national competitiveness through market mechanisms. The second objective, secure and equitable society, requires a well-devised social safety net, a sustainable social security system, and a social investment scheme that can provide opportunities for upward social mobility to all members. As the third objective, a stable and respected country means a country where conflicts and confrontations are resolved rationally via social dialogue, negotiation, and mutual trust. It is respected internationally by its contribution to international society and by becoming a model for other less developed countries. For specific contents of the plan, see the 'Social Policy Vision 2030' published by the Korean government.

¹⁸ The idea of the Giddens' The Third Way had been a popular discourse about the future model of European welfare state during the 1990s.

the Roh Moo-hyun government ended.

While the Roh Moo-hyun government established a long-term and comprehensive welfare vision under the name of the Vision 2030, it began to improve some existing social welfare programs and make new programs. These reforms would be a part of the long-term vision as well as the agendas that have been continuously raised since the previous Kim Dae Jung government.

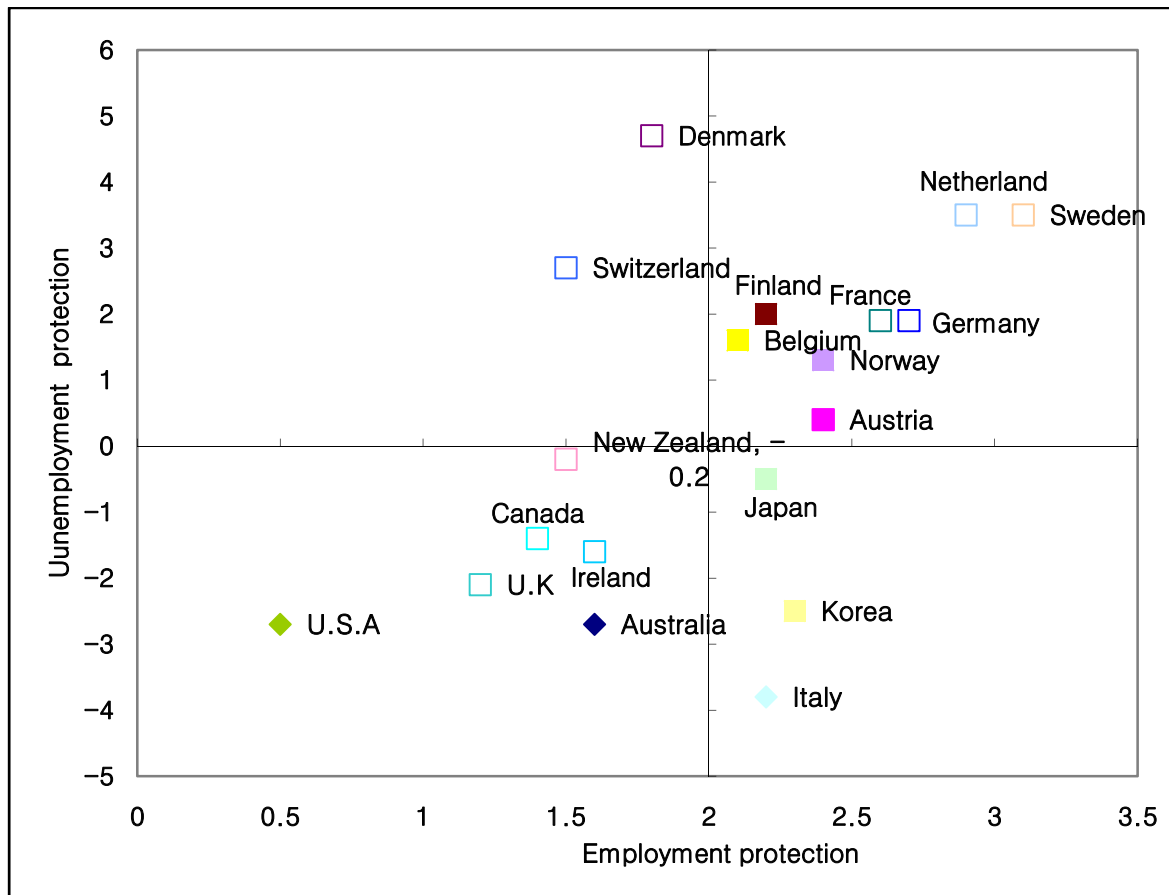
The most impending reform agenda was to reform the National Pension Program. As mentioned above, a distinctive achievement of the Kim Dae Jung government's productive welfare was to universalize the national pension program by expanding its coverage to the entire population under a unified insurance structure. However, it had serious innate defects in terms of long-term financial sustainability and protection of the low-income old aged, due to the program structure with low contribution and high benefit and a low rate of actual benefit coverage.¹⁹

There had been a series of policy debates regarding how to reform the current pension programs.²⁰ But the reform efforts turned out to be a small scale of parameter reform by lowering the benefit level for delaying the time of the deficit and introduced a pension assistance program for the low-income old aged. In addition to the reform of the national pension program in preparation for the old aging society, the Roh government enacted old-age, long-term care insurance program in April of 2007 and scheduled it for implementation from July of 2008. The idea of the long-term care insurance program was originated from the Kim Dae Jung government.

<Figure 13> Social Protection and Skill Formation Regime

¹⁹ Although, in 1998 the NPS was reformed by reducing the average replacement rate to 60% and raising the contribution rate to 9%, it was estimated that the scheme would have deficit in 2036, exhausting its fund by 2047. Ensuring financial sustainability—defined as a reserve fund large enough to pay two years of benefits—through 2070 would have required boosting the contribution rate to nearly 20% by 2030.

²⁰ A bill was introduced in the National Assembly in 2003 to reduce the replacement rate from 60% to 50% in 2008, accompanied by a rise in the contribution rate to 15.9% by 2030. However, this proposal was blocked by the National Assembly. Finally, in December 2006, a compromise was approved by a committee in the National Assembly to lower the replacement rate to 50% (an annual accrual rate of 1.25%), while boosting the contribution rate to 12.9% by 2018.



Reconstruction (including Korea) based on Estevez-Abe, Soskice, and Iversen (2001)

Note: Employment protection: OECD EPL score. (OECD, 2004)

Unemployment protection: i) average net replacement of unemployment benefit five-year, ii) generosity of unemployment benefit, iii) the expenditure of active labor market policy (OECD, 2006)

Cho (2007).

As we have seen, universal social insurance programs achieved by the Kim Dae Jung government have been crippled by the institutional tensions with the labor market and liberalized economic system. The insurance-based social protection with a strict contribution rule for the benefit cannot protect the wide spreading new poverty problems of the working poor. They are mainly irregular workers and the people in the marginal sector. There are also rapidly increasing demand for care services. However, these problems have not been yet significantly resolved in the Roh Moo-hyun government. Besides of the ambitious long-term plan, the actual achievements of the Roh Moo-hyun government were gradual improvements based on the previous problems and institutional features.

To find out the relationship between the production and welfare regimes in Korea from a comparative perspective, the Estevez and et al.'s measure for the relationship between skill specification and social protection was used including Korea as in <Figure 13>. It shows that Korea placed in very low level of unemployment protection like the countries in LMEs

model, and slightly high employment protection in comparison with the liberal model. However, the index used here is the OECD indicator measuring the legal structure of employment protection. If we consider the dual labor market structure in Korea, the Korea's position could be placed at the low-right side, which the LME countries are located. In this sense, according to the formal measurable indicator, the relationship between the production and welfare regime is closer to the liberal model.

IV. Conclusion: Hybridization of Modes of Coordination and Searching for an Alternative Model

As we have seen, the extensive neo-liberal economic reforms since the financial crisis have now transformed the production regime into being formally much closer to the neo-liberal model. The Korean economy is opened and now operating in response to market signals more than ever before. Especially the reforms of the financial and corporate sectors took away a powerful instrument from the state in controlling the financial sector and thus guiding the business investments. The overarching and intensive industrial policies of the past developmental state are now no longer possible. Economic volatilities have intensified and the business investment patterns have become passive and very sensitive to the market's short-term signals. While the labor market became more flexible overall, the rigidities within the organized internal market were strengthened. Employment practices became short-term based with the increasing portions of irregular workers within firms. But as the large business groups played an important role in the competitiveness of national economy and the production size, they also began to have a dominant role coordinating the various areas of the economy.

Nonetheless, the government is still playing a active role coordinating and upgrading the economy. The institutional practices by major actors such as state bureaucrats, the *chaebols*, and the organized labor have not yet radically changed into those shown in the liberal model, which often relies on previous practices and non-market coordination mechanisms. Some institutional legacies of the developmental state remained present throughout the reform process, coming to life for coordination efforts whenever necessary.

In this context, there are interesting and controversial issues as to how to explain the

institutional changes and what the institutional changes would mean in a real sense.²¹ In terms of the formal institutional changes, the Korean production regime is now becoming much similar to the liberal model. But in terms of the changes in informal dimensions of institutions and actual practices, some institutional legacies established in the previous era of the developmental state still remain as adapted forms and are playing a coordinated role in certain areas.

Does it mean that the Korean production regime is converging to the liberal model or transforming itself into another kind of coordinated economy adapting to changing environments? During the past industrialization period, especially the 'big push' led by the authoritarian developmental state, the major actor in coordinating the economy had been the state itself. In other words, the state had a heavy hand in directing business investment, controlling labor interests and demands, and managing the macro-economic policies in favor of the rapid industrialization. The state manipulated both business and labor with a crafty mix of the state-directed intervention, on the one hand, and the deployment of market disciplines and competitions in the areas of business production and wage determination (Chung, 1994; Chang, 1993).²² This double-edged coordinating strategy might be a unique feature that can be found in the East Asian developmental states.

After the economic crisis of the heavy chemical industrialization during the 1970s, the state began to intentionally liberalize the economy. And the democratization since the late 1980s accelerated the liberalization process. Therefore, the state could not directly coordinate in the economy either as a result of the intended liberalization or the democratization, alternative coordinating mechanism needed to emerge and replace the state's direct role. It could be the market principle as in the liberal model or a non-market mode of coordination based on political consensus among the major actors as in the non-liberal market economies.

For example, some non-liberal capitalist countries such as Germany and Japan, which had successfully been industrialized by the authoritarian developmental state, had developed consensus-based coordinating institutions and mechanisms in the place of the

²¹ There are interesting debates about which the institutional change is real between formal and informal institutional change (Culpepper, 2005). In explaining the changing financial sector, he argues that "although legal reform is often a necessary condition for institutional change in coordinated financial system, such reform is not a sufficient condition because shared beliefs can persist in the face of formal legal change" (Culpepper, 2005: 176). According to him, the sufficient condition for institutional change is "joint belief shift," that is, changed ideas and practices rather than the change in the formal rules.

²² Valenzuela interestingly suggests that many authoritarian regimes had used a dual strategy for controlling labor: on the one hand, the state controlled the organized labor under the state coporatist framework, and at the same time, it employed a market strategy by placing labor in the harsh market discipline (Valenzuela, 1986).

state's more or less direct interventions since their democratization. Since the World War II, Germany was able to institutionalize the democratic corporatist institutions based on the relatively balanced power relations between business and labor, while Japan developed the non-liberal coordination mechanism based on the hegemonic power of large businesses under a conservative ruling coalition (Streeck and Yamamura, 2001).

However, as we will see in the later section on the changing political regime, the idea of the neo-liberalism had emerged before the financial crisis and been much stronger than any other alternative mode of coordination. But the specific idea of neo-liberalism is not the same as that in today's Anglo-American model and has been shaped by particular historical sequences of the ruling coalition in the process of liberalization process--the early democratization by the conservative ruling coalition, the financial crisis, and the power shifting ruling coalition.

Today, Korea is experiencing a critical historical juncture where the old institutional features and ideas are being dismantled or readapted, and new ideas and institutions are being shaped by the globalization pressures and the democratization. In this transition period, the institutional arrangement looks like a 'hybridization' in which the old and newly emerging institutions are contradictorily intermingled, interacting each other, and searching for new institutional complementarities (Deeg, 2005; Höper, 2005). Therefore, a more important aspect of institutional change is not at the formal level, but the informal level (Culpepper, 2005). In this sense, the actual operating and functioning of the production regime will depend ultimately on the politics and hegemonic power over the specific ideas of the production regime and the competing ruling coalitions.

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